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15-2990
No. 14262

**United States
Court of Appeals
For the Ninth Circuit.**

PERCY P. DAVIS,

Appellant,

vs.

GUY F. ATKINSON COMPANY, a Corporation,
and J. A. JONES CONSTRUCTION COM-
PANY, a Corporation,

Appellees.

Transcript of Record

**Appeal from the United States District Court for the
Northern District of California,
Southern Division.**

FILED

JUN -8 1954

No. 14262

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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Assistant United States Attorney,
San Francisco, Calif.,

Attorneys for Defendant and Appellee.

In the District Court of the United States, Northern
District of California, Southern Division

No. 28816H

PERCY P. DAVIS,

Plaintiff,

vs.

GUY F. ATKINSON COMPANY, a Corporation,
and J. A. JONES CONSTRUCTION COM-
PANY, a Corporation,

Defendants.

COMPLAINT FOR DAMAGES FOR BREACH
OF CONTRACT

Plaintiff above named, complaining of the defend-
ants in the above-entitled action, states and alleges:

I.

That this action is brought under the provisions
of Title 28, U.S.C., Section 41, and jurisdiction is
conferred upon this Court by that Act.

II.

That during all of the times herein mentioned
said plaintiff was a dentist duly authorized to prac-
tice his profession and maintaining an office in the
City of New York City, State of New York, and
residing in said City of New York City, and that said
plaintiff during all of said times was a member of
the Board of Health of said city.

III.

That during all of the times herein mentioned, said defendants were and now are corporations duly and regularly created and existing and duly authorized to transact business in the State of California. That said defendants, as joint venturers, were during all of said times, and now are, contractors under that certain contract No. W-04-470-Eng-1 with the War Department of the United States for the performance of certain construction work on the Island of Okinawa.

IV.

That during the month of November, 1947, at the City of New York City, State of New York, said defendants hired and employed said plaintiff for the period of not less than one year as a dentist to furnish dental care of an emergency nature only to the employees of said defendants at the site of the work performed by said defendants on the said Island of Okinawa, and said defendants agreed to pay to said plaintiff the sum of \$150.00 per week and to furnish transportation to said plaintiff from the said City of New York City to the said Island of Okinawa. That it was further understood and agreed between said plaintiff and said defendants that said plaintiff could engage in the private practice of dentistry on said Island of Okinawa and could furnish any dental work, other than work of an emergency nature, to the employees of the said defendants or to any other person for such compensation to be paid to said plaintiff as might be

agreed between him and said employees or other persons.

V.

That thereupon said plaintiff, relying upon the agreements and representations made as aforesaid, disposed of and sold his office and dental practice in said City of New York City, restricted himself for several years from practicing his said profession in said City of New York City, resigned from the Board of Health of said City, and sold a large portion of his dental equipment, and all of his furniture and furnishings and other belongings, and his automobile, and said plaintiff gave up his apartment, all at a substantial and serious loss to said plaintiff.

VI.

That thereafter and on the 5th day of December, 1947, at the City of Sausalito, County of Marin, State of California, the terms of the contract between said plaintiff and said defendants were reduced to writing by the said defendants and that a written contract was signed on the said 5th day of December, 1947, between said plaintiff and said defendants. That at the time of the signing and execution of said written contract, said defendants again represented to said plaintiff that the employees of said defendants, employed on the Island of Okinawa, were entitled under their contracts of employment with said defendants, to dental work of an emergency nature only: that said plaintiff could engage in the private practice of dentistry on said Island of Okinawa and furnish any other dental

work desired by said employees or by other persons and receive compensation therefor to be paid by said employees or other persons.

That thereupon, and relying upon the agreements and representations so made as aforesaid by said defendants, said plaintiff shipped to said Island of Okinawa complete Operative, Prosthetic, Crown and Bridge Kits and Engine, all of which equipment had no relation to emergency dental work. That said defendants authorized a special weight allowance to said plaintiff in shipping said equipment.

VII.

That pursuant to the term of said written contract, said defendants caused said plaintiff to be transported to Okinawa, where said plaintiff immediately entered upon the employ of said defendants pursuant to his agreement aforesaid.

VIII.

That after arriving on said Island of Okinawa said plaintiff was notified by said defendants that he could not engage in the private practice of dentistry, and said plaintiff was thereupon prevented by said defendants from engaging in such private practice. That said plaintiff was further notified by said defendants that he did not have a one-year contract but one terminable at the will of said defendants. That thereupon defendants refused and have ever since refused to allow said plaintiff to perform the duties and conditions on

his part of said contract of employment. and refused to pay him thereunder and said plaintiff was discharged and his said contract of employment cancelled and terminated without just cause and against his will.

IX.

That said plaintiff has fulfilled all the terms of his said contract of employment until said defendants cancelled and terminated said contract without reason or cause and contrary to the terms thereof. That said plaintiff has been at all times able, willing and anxious to perform the terms of his said contract of employment and the work for which he had been hired, and that his discharge was and is unlawful and without just cause and against his will and all contrary to and in violation of the terms of his said contract of employment with said defendants.

X.

That upon the termination of said contract and the discharge of said plaintiff, as aforesaid, said defendants refused to furnish to said plaintiff transportation from said Island of Okinawa to his home in New York City, New York, and that said plaintiff received no further compensation or salary or subsistence. That said plaintiff was compelled to and did pay for his subsistence until his return to New York City, and his expenses of transportation and of the transportation of his dental equipment from the Island of Okinawa to New York City, New York.

XI.

That by reason of the unlawful cancellation and termination of said contract of employment and the acts of said defendants as aforesaid, said plaintiff has been damaged in the sum of \$10,000.00 for the loss of his dental practice in New York City; in the further sum of \$2,000.00 for the loss of his position with the New York City Board of Health; in the further sum of \$300.00 for expenses from New York City to Okinawa; in the further sum of \$2,700.00 for expenses of transportation from Okinawa to New York City, including the return of his dental equipment; in the further sum of \$4,150.00 for the loss suffered by him upon the sale of his said automobile, dental equipment and furniture and furnishings.

XII.

That said plaintiff duly filed a claim with said defendants, but that said defendants have failed and refused and do now fail and refuse to pay said sums hereinabove mentioned or any part thereof, to plaintiff's damage in the sum of \$19,150.00.

XIII.

That by reason of the facts aforesaid said plaintiff has been damaged in the further sum of \$25,000.00 as and for general damages.

Wherefore, plaintiff prays judgment against defendants, and each of them in the sum of \$25,000.00 general damages, and the further sum of \$19,150.00 special damages, together with his costs and disbursements herein incurred, and for such other and

further relief as to the Court may seem just and proper.

/s/ G. H. VAN HARVEY,

/s/ PAUL C. THORNE,

Attorneys for Plaintiff.

Duly verified.

[Endorsed]: Filed April 27, 1949.

[Title of District Court and Cause.]

ANSWER OF DEFENDANTS

Now come the defendants above named and answer the complaint on file herein as follows:

I.

Defendants allege that the action is brought under the provisions of Title 28 U.S.C. Section 1332, and otherwise leave matters of jurisdiction to the Court.

II.

Defendants have no information or belief as to the allegations of Paragraph II and on such grounds deny said allegations.

III.

Defendants admit the allegations of paragraph III.

IV.

Defendants deny the allegations of paragraph IV, and in this respect allege that on the 5th day of December, 1947, at Sausalito, California, plaintiff and defendants entered into a written contract of

employment, a copy of which is attached hereto, made a part hereof and marked Exhibit A.

V.

Defendants deny the allegations of Paragraph V.

VI.

Answering Paragraph VI defendants admit that on the 5th day of December, 1947, at the City of Sausalito, County of Marin, State of California, plaintiff and defendants entered into the contract hereinabove referred to, and attached hereto as Exhibit A. Deny the remaining allegations of said Paragraph VI.

VII.

Defendants admit the allegations of Paragraph VII

VIII.

Defendants admit that after arriving on said Island of Okinawa plaintiff was notified by defendants that he could not engage in the private practice of dentistry, and in this respect allege that under the terms and conditions of the written contract of employment, Exhibit A, there was no agreement with defendants that plaintiff could engage in the private practice of dentistry and that said private practice of dentistry was not authorized by defendants and that plaintiff did not have the permission of defendants to so engage in the private practice of dentistry on the Island of Okinawa. Defendants deny that plaintiff was further notified at said time by defendants that he did not have a

one-year contract but one terminable at the will of said defendants, and in this respect specifically refer to the terms and conditions of the said written contract between plaintiff and defendants, Exhibit A hereof, and particularly Section 2 thereof, which said contract and said section were in full force and effect at the time alleged in said Paragraph VIII. Defendants deny that defendants thereupon refused and have ever since refused to allow said plaintiff to perform the duties and conditions on his part as set forth in said contract of employment and in this respect allege that plaintiff failed to perform the duties and conditions on his part of said contract of employment. Defendants deny that they refused to pay plaintiff under the terms of said written contract, Exhibit A, and in this respect allege that plaintiff had received payment of any and all sums to which he may have been entitled or which may have been due and owing to him in accordance with the terms and provisions of said written contract of employment, Exhibit A. Defendants admit that plaintiff was discharged and deny that said written contract of employment was cancelled and terminated without just cause and against plaintiff's will, and in this respect allege that plaintiff was discharged for cause in accordance with the terms and provisions of said written contract of employment, Exhibit A.

IX.

Defendants deny the allegations of paragraph IX.

X.

Defendants admit the allegations of paragraph X.

XI.

Defendants deny the allegations of paragraph XI and particularly that plaintiff has been damaged in the sum of \$10,000.00 or any part thereof for the loss of his dental practice; that he has been damaged in the amount of \$2,000.00 or any part thereof for the loss of his position with the New York Health Department; that he has been damaged in the sum of \$300.00 or any part thereof for expenses from New York City to Okinawa; that he has been damaged in the sum of \$2,700.00 or any part thereof for expenses of transportation from Okinawa to New York City, including the return of his dental equipment; that he has been damaged in the sum of \$4,150.00 or any part thereof for the loss suffered by him upon the sale of his said automobile, dental equipment and furniture and furnishings.

XII.

Defendants deny that plaintiff duly filed a claim with defendants. Admit that defendants have failed and refused and do now fail and refuse to pay any of the sums or any part thereof as set forth in paragraph XI of said complaint. Defendants deny that plaintiff has been damaged in the sum of \$19,500.00 or any part thereof.

XIII.

Defendants deny that plaintiff has been damaged in the sum of \$25,000.00 or any part thereof. De-

defendants deny that plaintiff has been damaged in the sum of \$44,150.00 or any part thereof.

As and for a Second, Separate and Distinct Answer and Defense to Plaintiff's Complaint Defendants Allege as Follows:

I.

That plaintiff's complaint does not state facts sufficient to constitute a cause of action.

As and for a Third, Separate and Distinct Answer and Defense to Plaintiff's Complaint Defendants Allege as Follows:

I.

That on the 5th day of December, 1947, at Sausalito, California, plaintiff and defendants made and entered into that certain contract in writing hereinabove referred to and made a part hereof as Exhibit A; that in accordance with the terms and provisions of said contract plaintiff was transported to the Island of Okinawa; that thereafter, contrary to specific instructions given to him by defendants and in violation of the terms and provisions of said contract, Exhibit A, plaintiff conducted the private practice of dentistry while employed under the terms and provisions of said written contract, Exhibit A, on the Island of Okinawa, and did demand and receive fees and gratuities from employees of defendants for dental services rendered to such employees of defendants, all of which dental services in accordance with the terms and provisions of said

written contract, Exhibit A, were to be rendered without charge.

II.

That prior to December 5, 1947, the day upon which the said written contract of employment, Exhibit A, was executed, plaintiff was informed and advised that demand or acceptance of any fees or gratuities by him for dental services rendered by him to employees of defendants would constitute grounds for discharge; that upon plaintiff's arrival at Okinawa he was further advised and warned that demand or acceptance of any fees or gratuities would constitute grounds for discharge, and that notwithstanding such advice and such warning and the provisions of the said written contract of employment, Exhibit A, plaintiff did demand, receive and accept fees and gratuities from said employees of defendants for dental services rendered to such employees in accordance with the terms and provisions of said contract of employment, Exhibit A; that thereafter, in accordance with the terms and provisions of said written contract of employment, Exhibit A, plaintiff was discharged for cause.

III.

That defendants have at all times fully performed all the terms and conditions of said written contract of employment, Exhibit A, on their part to be performed, and have paid to plaintiff in full any and all sums of money to which plaintiff may have been entitled in accordance with the terms and provisions of said written contract of employment, Exhibit A.

Wherefore, defendants pray that the complaint herein be dismissed and defendants have their costs of suit and such other and further relief as may be meet and proper in the premises.

/s/ FRANK J. HENNESSY,
United States Attorney.

/s/ C. ELMER COLLETT,
Assistant United States Attorney, Attorneys for
Defendants.

[Title of District Court and Cause.]

INTERROGATORIES PROPOUNDED BY DEFENDANTS TO PLAINTIFF UNDER RULE 33 FEDERAL RULES OF CIVIL PROCEDURE

To: The above-named Plaintiff, and to Paul C. Thorne and G. H. Van Harvey, his attorneys:

The following Interrogatories are hereby propounded to the plaintiff with the request that he answer the same under oath as in said rule provided:

I. During the time you were employed by defendants in Okinawa, did you, in addition to services performed and compensation received under your written agreement with defendants,

(a) Offer to perform dental work for any person or persons in return for remuneration in any form whatsoever?

(b) Agree to perform dental work for any person or persons in return for remuneration in any form whatsoever?

(c) Perform dental work for any person or persons for which you made a charge of any kind?

(d) Perform dental work for any person or persons for which remuneration in any form was received by you?

(e) Offer or agree to perform dental work for any person or persons who delivered to you money, goods, or other property of any kind?

(f) Perform dental work for any person or persons who delivered to you money, goods, or other property of any kind?

(g) Engage on your own account in the private practice of dentistry?

II. If your answer to any of the questions covered by Interrogatory No. I (a) to (g), inclusive, be in the affirmative, please state with respect to each,

(a) The name of the person or persons involved.

(b) The date or dates of the occurrences mentioned.

(c) The nature of the remuneration or property received, charged, or paid.

(d) The nature of the dental work offered, agreed to or performed.

III. What is the name and position of each person who you claim represented to you that you would be entitled to engage in the private practice of dentistry on the Island of Okinawa?

IV. When and where and in whose presence were each such representations made?

/s/ FRANK J. HENNESSY,
United States Attorney;

/s/ C. ELMER COLLETT,
Assistant United States
Attorney;

/s/ ANTOINETTE E. MORGAN,
Assistant United States
Attorney,
Attorneys for Defendants.

[Endorsed]: Filed March 9, 1950.

[Title of District Court of Cause.]

ANSWERS OF PLAINTIFF TO INTERROGATORIES PROPOUNDED BY DEFENDANTS

Comes now Percy P. Davis, plaintiff above named, and in response to the interrogatories numbered I (a) to IV, both inclusive, propounded to him in the above-entitled action, makes the following answers:

Answer to Interrogatory I (a):

Yes.

Answer to Interrogatory I (b):

Yes.

Answer to Interrogatory I (c):

Yes.

Answer to Interrogatory I (d):

Yes.

Answer to Interrogatory I (e):

Yes.

Answer to Interrogatory I (f):

Yes.

Answer to Interrogatory I (g):

Yes, but my private practice of dentistry was limited only to dental procedures above and beyond those of an emergency nature.

Answer to Interrogatory II(a):

E. Covington; Kenneth J. Dowse; Larry Ericks; J. Hagen; J. LaGoda; L. O. Taylor; W. A. Traynor; N. F. Anderson—there may be several others, whose names I do not remember at this time, who received minor elective dental work not classified as immediate or emergency in nature.

Answer to Interrogatory II (b):

I cannot give the exact date or dates of each of said occurrences, but they all appear to have taken place between December 30, 1947, and January 17, 1948.

Answer to Interrogatory II (c):

On January 17, 1948, I received the sum of \$56.00 from E. Covington as deposit in payment for repair of partial, addition of tooth and gold inlay pending an answer to the memorandum which I sent to the management.

On January 11, 1948, I received the sum of \$14.00 from Kenneth J. Dowse as deposit for inlay, pending a reply to my memorandum to the management.

I received no money from Larry Ericks, J. Hagen, J. LaGoda. There may be several other men who were furnished minor elective dental work not classified as immediate or emergency in nature and who paid either in cash or cartons of cigarettes or both. Cigarettes were recognized as a form of exchange in Okinawa at the time on the same basis as cash.

Answer to Interrogatory II (d) :

The dental work which I offered, agreed to or performed for remuneration was dental work other than of an emergency nature.

As I stated I received a deposit of \$56.00 from E. Covington for partial, addition of tooth and gold inlay.

I made a gold inlay for Kenneth J. Dowse for which, as I previously stated, I received a deposit of \$14.00.

I offered to make Larry Ericks an upper, partial one-piece casting. I received no money for this on account of this work.

I agreed with J. Hagen to make a full upper plate pending clarification by the management. This patient was greatly depressed as a result of having no teeth with which to chew the "grub." The previous dentist, Dr. Lessner, had removed this man's teeth and he needed artificial dentures badly. I received no money from this patient.

I advised J. LaGoda that I would do an inlay pending clarification by the management. I received no money from this patient.

I advised L. O. Taylor that I would let him know as to his dental work pending a reply from the management.

I also advised W. Traynor that I would let him know concerning proposed bridge work as soon as I received a reply from the management.

I was also consulted by N. F. Anderson and offered to make a full upper denture pending a reply from the management.

I was also consulted by several men, among them T. J. Gaut, Robert G. Ott, J. Murray and N. F. Anderson about work done for them by the previous dentist who received money from them and then skipped without furnishing the dental work contracted for or without refunding the money. These men came to me and I told them to make a report to the management regarding their complaints.

Answer to Interrogatory III:

George A. Gardner, of New York City, personnel manager for Atkinson-Jones Construction Company. Robert E. Doyle, personnel manager of said company at Sausalito, California.

Answer to Interrogatory IV:

The representations made by George A. Gardner were made in New York City prior to leaving for San Francisco. He said that he could conceive of no objection on the part of the management to such an arrangement but that, however, further details would have to be worked out with the office in Sausalito.

After arriving in Sausalito and before signing the contract with Atkinson-Jones Construction Company on December 5, 1947, Mr. Robert E. Doyle stated to me, in his office at Sausalito, that the employees of his company were entitled to dental work of an emergency nature only; that they would have

to pay for any other dental work except work of such immediate or emergency nature.

We discussed the conditions under which we had previously worked on other contract positions. Mr. Doyle described the difficulties which had arisen between the previous dentist and management on Okinawa—wherein men who were treated were dissatisfied and unhappy with the type and standard of dental service rendered them. I assured Mr. Doyle that I guaranteed all my dental work unconditionally on the basis of “100% satisfaction or entire fee refunded.” I informed Mr. Doyle that we had the necessary dental equipment and supplies ready for complete dental service and requested permission for extra weight allowance. He stated his approval for the extra weight shipment and further stressed to me before Mr. L. C. Fassett and Mr. Keenan that any work that we might do, other than that of emergency nature, would be between the patient and myself.

/s/ PERCY P. DAVIS,
Plaintiff.

Duly verified.

Receipt of copy acknowledged.

[Endorsed]: Filed April 19, 1950.

[Title of Distret Court and Cause.]

MOTION FOR SUMMARY JUDGMENT

Defendants, Guy F. Atkinson Company and J. A. Jones Construction Company, respectfully move the court for a summary judgment dismissing this suit, on the following ground:

I.

That the above-entitled court is without jurisdiction of the subject matter of said action for the reason that the same is an action between citizens of different states, and that it appears to a legal certainty from the pleadings and admissions on file herein that the matter in controversy does not and cannot exceed the sum or value of \$3000.00, exclusive of interest and costs. (28 U.S.C. 1332). That there is, therefore, no genuine issue as to any material fact and defendants are entitled to judgment for dismissal as a matter of law. (Federal Rules of Civil Procedure, Rule 56.)

Wherefore, defendants pray for a summary judgment dismissing said action.

/s/ CHAUNCEY TRAMUTOLO,
United States Attorney;

/s/ ANTOINETTE E. MORGAN,
Assistant United States
Attorney.

EXHIBIT A

Original Filed

July 7, 1948

File Clerk, U. S. District Court

San Francisco

In the United States District Court for the Northern District of California in the Southern Division

No. 27141-G

AARON M. SARGENT,

Plaintiff,

vs.

J. H. POMEROY, INCORPORATED a Corporation,

Defendant.

MEMORANDUM AND ORDER

At the trial of this cause plaintiff attempted to elicit oral statements made prior to the execution of the formal written agreement. Objection was made and sustained upon the ground that this constituted an attempt to vary the terms of the written agreement. At the afternoon session which followed this ruling plaintiff renewed his offer. He was quite confident of his position. It was apparent that the **entire cause of action** which he espoused depended upon the ruling. Briefs were therefore invited.

It is elementary that all oral negotiations and understandings are merged in the writing, or rather disappear in a legal sense, when a written agree-

ment is entered into as the contract between the parties and such oral statements may be resorted to only for the purpose of showing the real understanding of the parties in case of ambiguity in the contract. Plaintiff's chief point is that there exists ambiguity in the Contract in question, especially as to the term of employment. He points to the following paragraph therein:

“3. The period of service shall be such period as the Employer may desire the services of the Employee, it being understood that the Employee may be transferred from job and/or site of work to another within the Western Pacific Area, if desired by the Employer, but the Employer will not require the Employee to remain in the Western Pacific Area more than twelve (12) months without his consent. The Employee agrees to work for the Employer in accordance with the terms of this Contract until the termination of the period of service.”

I find no ambiguity. The writing expresses in understandable and plain language that the employee will work for the employer for a period of one year, and the employer will hire him for such time as the employer elects.

Plaintiff now raises the point that the contract is not enforceable because of a want of mutuality. He directs attention to the fact that the employee is bound to perform for at least a twelve months period but that the employer may terminate the employment whenever he sees fit.

Pursuant to the contract and in compliance there-

with, and following its execution, the employees, assignors of plaintiff, were transported by defendants to the place of work in the Orient where they performed the agreed services for a length of time. The contract was terminated by the employer under the privilege reserved to it within the twelve months period.

Assuming that the contract at its inception lacked mutuality, it was later executed. It was performed by both parties up to time of its termination, all strictly within its terms. This performance and the conduct of the parties made the contract enforceable. Any lack of mutuality was cured by both parties performing. The consideration relates back to the promise of the employee through performance by him. He has enjoyed the fruits of the understanding. This creates a mutuality of remedy. *Willard, Sutherland & Co. v. U.S.* 262 U.S. 489; 17 C.J.S. 448.

The understanding reached and expressed by the court at the conclusion of the trial was that a further trial would be had if the court ruled in favor of plaintiff upon the question raised. My ruling precludes occasion for further evidence.

Judgment will be for defendant who is to prepare findings in accordance with the local rule.

Dated: July 7, 1948.

/s/ DAL M. LEMMON,

United States District Judge.

Original filed July 7, 1948, file clerk U. S. District Court, San Francisco.

EXHIBIT B

(Copy)

In the Superior Court of the State of California in
and for the City and County of San Francisco

No. 370395

JOHN A. WILSON, et al.,

Plaintiffs,

vs.

GEORGE POLLOCK and GORDON POLLOCK,
Individually and Doing Business as STOCK-
TON-POLLOCK SHIPBUILDING COM-
PANY, a Copartnership, et al.,

Defendants.

JUDGMENT OF NON-SUIT

The above cause came on regularly for trial on March 22, 1951, before the above-entitled court, with a jury, Honorable Frank T. Deasy presiding, upon the fifth and sixth causes of action alleged in the complaint filed herein, and the defendant's answer thereto filed herein, Hugh B. Miller, Esq., and Julius M. Keller, Esq., appearing as attorneys for plaintiff Cecil E. Stemler; Frank J. Hennessy, United States Attorney for the Northern District of California, by Macklin Fleming and Antoinette E. Morgan, Assistant United States Attorneys, appearing for the defendants. At said trial, evidence, both oral and documentary, was introduced on behalf of the plaintiff, Cecil E. Stemler, and said

plaintiff then rested. Whereupon defendants moved the court for a judgment of non-suit herein on the ground that no evidence was introduced at said trial of any breach by any of the defendants of the terms of the written contract between said plaintiff and said defendants, upon which this action is based, or of the making by said defendants to said plaintiff of any false, fraudulent or untrue statement or representation in connection with said contract or with the employment of plaintiff thereunder.

Said motion having been submitted to the court for decision and the court being fully advised,

It Is Therefore, Ordered, Adjudged and Decreed that defendants' motion for judgment of non-suit herein be, and the same is hereby granted, and the above-entitled cause is, as to the plaintiff. Cecil E. Stemler, dismissed, and defendants shall recover their costs of suit herein.

Dated May 21, 1951.

FRANK T. DEASY,

Judge of the Superior Court.

Filed May 21, 1951, Superior Court.

Affidavit of service by mail attached.

[Endorsed]: Filed March 6, 1952. U.S.D.C.

[Title of District Court and Cause.]

ORDER GRANTING MOTION FOR
JUDGMENT OF DISMISSAL

It affirmatively appears from the pleadings, admissions and stipulations that any recovery under the terms of the written contract sued upon would be less than \$3000.00. *Thus the court lacks jurisdiction of the cause. 28 U.S.C. 1332.

It may be that suit or an amended complaint may lie for damages in the jurisdictional amount for fraud or deceit or misrepresentation inducing the execution of the contract.

For that reason, the motion for summary judgment of dismissal is granted without prejudice.

Dated: July 17, 1952.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed July 17, 1952.

*No general or special damage, as claimed in the complaint, is recoverable under the contract, inasmuch as by its provisions, defendants could terminate the contract without cause. In that event, only transportation expenses and travel pay are recoverable. The amount thereof is stipulated to be less than \$3000.00. In the event of termination for cause, neither travel pay nor transportation expenses are recoverable.

[Title of District Court and Cause.]

AMENDED COMPLAINT FOR DAMAGES

Now comes plaintiff above named, and for his amended complaint in the above-entitled action, states and alleges:

I.

That during all of the times herein mentioned said plaintiff was a dentist duly authorized to practice his profession and maintaining an office in the City of New York City, State of New York, and residing in said City of New York City, and that said plaintiff during all of said times was a member of and employed by the Board of Health of said City.

II.

That during all of the times herein mentioned said defendants were and now are corporations duly and regularly created and existing and duly authorized to transact business in the State of California. That said defendants, as joint venturers, were during all of said times contractors under that certain contract No. W-04-470-Eng-1 with the War Department of the United States for the performance of certain construction work on the Island of Okinawa, and that said defendants were during all of said times engaged in such construction work on said Island of Okinawa pursuant to said contract.

III.

That on and prior to the month of November, 1947, in the City of New York City, State of New

York, and at other places, said defendants fraudulently, and with the intent to induce said plaintiff and others to seek employment with said defendants on said Island of Okinawa, did falsely publish, advertise and represent to the public at large, and to said plaintiff, that men were wanted by said defendants for employment on said Island of Okinawa under a one year contract for the performance of work pursuant to said contract between said defendants and the War Department of the United States: and that transportation to and from said Island of Okinawa would be furnished by said defendants; and that limited dental care would be furnished the employees of said defendants without charge.

IV.

That during the month of November, 1947, at the said City of New York City, State of New York, said defendants wrongfully, falsely and fraudulently represented to said plaintiff that if said plaintiff would enter the employment of said defendants as a dentist on the Island of Okinawa, said defendants would hire and employ said plaintiff as such dentist for a period of not less than one year to furnish dental care of an emergency nature only to the employees of said defendants at the site of the work performed by said defendants on the said Island of Okinawa: and that said defendants would pay to said plaintiff the sum of \$150.00 per week and would furnish transportation to said plaintiff from the said City of New York City to the said Island of Okinawa; and that said plaintiff could engage in

the private practice of dentistry on said Island of Okinawa and could furnish any dental work, other than work of an emergency nature, to the employees of the said defendants or to any other person or persons for such compensation as might be agreed upon between said plaintiff and said employees or persons.

V.

That said plaintiff, confiding in and relying wholly upon the representations aforesaid made to him by said defendants, and relying upon the general reputation of said defendants, accepted such employment upon the terms and conditions hereinabove alleged, and that thereupon said plaintiff disposed of and sold his office and dental practice in said City of New York City, restricted himself for several years from practicing his said profession in said City of New York City, resigned from the Board of Health of said city, and sold a large portion of his dental equipment, and all of his furniture and furnishings and other belongings and his automobile, and said plaintiff gave up his apartment, all at a substantial and serious loss to said plaintiff.

VI.

That thereafter and on the 5th day of December, 1947, at the City of Sausalito, County of Marin, State of California, said defendants wrongfully and fraudulently, and with the intent to induce said plaintiff to enter into the employment of said defendants and to sign and execute the written contract of employment hereinafter referred to, did

again falsely represent to said plaintiff that the employment of said plaintiff by said defendants would be for a period of not less than one year; that the employees of said defendants, employed on the said Island of Okinawa, were entitled under their contracts of employment with said defendants to dental work of an emergency nature only; and that said plaintiff could engage in the private practice of dentistry on said Island of Okinawa and furnish any other dental work desired by said employees or by other persons and receive compensation therefor to be paid by said employees or other persons.

That said defendants, by means of said false, fraudulent and deceitful pretenses and representations, after making the same as aforesaid, wrongfully and fraudulently induced said plaintiff to sign and execute a certain written contract, dated on the 5th day of December, 1947, purporting to hire and employ said plaintiff as a dentist at the site of the construction work performed by said defendants on the said Island of Okinawa, and that said plaintiff did then and by reason thereof sign and execute said written contract.

VII.

That thereupon, and relying upon the representations so made as aforesaid by said defendants, said plaintiff shipped to said Island of Okinawa a complete operative, prosthetic, crown and bridge kits and engine, all of which equipment had no relation to emergency dental work, and that said defendants authorized a special weight allowance to said plain-

tiff in shipping said equipment. That thereupon said defendants caused said plaintiff to be transported to said Island of Okinawa, where said plaintiff immediately entered upon the employ of said defendants.

VIII.

That each of the representations so made was false and fraudulent, and was designedly, falsely and fraudulently made for the purpose of deceiving said plaintiff and inducing him to enter into the employment of said defendants upon their own terms and conditions and to sign and execute the said purported written contract of employment; that said plaintiff relied wholly upon the representations of the said defendants, and believed them and each of them to be true, and was induced thereby, and not otherwise, to enter into the said employment and to sign and execute the said written contract, and would not have entered said employment or executed said contract had he not believed said representations and each of them to be true. That in truth and in fact, said defendants well knew that said employment was terminable at the will of said defendants, and that under the rules and regulations of the United States applicable to said Island of Okinawa the said plaintiff could not engage in the private practice of dentistry on said Island.

IX.

That after arriving on said Island of Okinawa said plaintiff was notified by said defendants that he could not engage in the private practice of den-

tistry, and that said plaintiff was thereupon prevented by said defendants from engaging in such private practice. That said plaintiff was further notified by said defendants that he did not have a one year contract but that his employment could be terminated at any time at the will of said defendants. That thereupon said defendants refused and have ever since refused to allow said plaintiff to perform the duties of his employment, or to engage in the private practice of dentistry on said Island of Okinawa, and that said plaintiff was thereupon discharged and his employment terminated without just cause and against his will.

X.

That said plaintiff has been at all times able, willing and anxious to perform the terms of his employment and the work for which he had been hired, and that his discharge was and is unlawful and without just cause and against his will and all contrary to and in violation of the terms of his employment with said defendants.

XI.

That upon the termination of said employment and the discharge of said plaintiff as aforesaid, said defendants refused to furnish the said plaintiff transportation from said Island of Okinawa to his home in New York City, New York, and that said plaintiff received no further compensation or salary or subsistence. That said plaintiff was compelled to

and did pay for his subsistence until his return to New York City, and his expenses of transportation and of the transportation of his dental equipment from the Island of Okinawa to New York City.

XII.

That by reason of the facts aforesaid said plaintiff has been damaged in the sum of Ten Thousand and no/100 (\$10,000.00) Dollars for the loss of his dental practice in New York City; in the further sum of Two Thousand and no/100 (\$2,000.00) Dollars for the loss of his position with the New York City Board of Health; in the further sum of Two Thousand Seven Hundred and no/100 (\$2,700.00) Dollars for expenses of transportation from said Island of Okinawa to New York City, including the return of his dental equipment; in the further sum of Four Thousand One Hundred Fifty and no/100 (\$4,150.00) Dollars for the loss suffered by said plaintiff from the sale of his said automobile, dental equipment and furniture and furnishings.

XIII.

That by reason of the facts aforesaid said plaintiff has been damaged in the further sum of Twenty-five Thousand and no/100 (\$25,000.00) Dollars as and for general damages.

Wherefore, said plaintiff prays judgment against said defendants, and each of them, in the sum of Twenty-five Thousand and no/100 (\$25,000.00) Dollars general damages and the further sum of Eighteen Thousand Eight Hundred Fifty and no/100

(\$18,850.00) Dollars special damages, together with his costs and disbursements incurred, and for such other and further relief as to the Court may seem just and equitable.

/s/ G. H. VAN HARVEY,
Attorney for Plaintiff.

Duly verified.

[Endorsed]: Filed January 22, 1953.

[Title of District Court and Cause.]

ANSWER TO AMENDED COMPLAINT
FOR DAMAGES

Come Now defendants Guy F. Atkinson Company and J. A. Jones Construction Company, and answering the amended complaint of plaintiff on file herein, allege as follows:

I.

Defendants are without sufficient information or belief to answer the allegations of paragraph I, and placing their denial on that ground, deny such allegations.

II.

Admit the allegations of paragraph II.

III.

Deny the allegations of paragraphs III, IV, V and VI.

IV.

Answering the allegations of paragraph VII, admit that defendants caused plaintiff to be transported to Okinawa, where plaintiff immediately entered upon the employ of said defendants. Deny the remaining allegations of paragraph VII.

V.

Answering the allegations of paragraph VIII, admit that pursuant to the express terms of the written contract entered into by the plaintiff and defendants on the 5th day of December, 1947, plaintiff's employment was terminable at the will of said defendants. Admit that under the rules and regulations of the United States applicable to Okinawa, plaintiff could not engage in the private practice of dentistry on said island. Deny the remaining allegations of paragraph VIII.

VI.

Answering the allegations of paragraph IX, admit that after arriving on Okinawa, plaintiff was notified by defendants that he could not engage in the private practice of dentistry, and in this respect allege that under the terms and conditions of the written contract of employment between plaintiff and defendants there was no agreement with defendants that plaintiff could engage in the private practice of dentistry. It is further alleged that at no time, either before or after the signing of said contract, did defendants, or either of them, author-

ize plaintiff, or represent to plaintiff, that he would be permitted to engage in the private practice of dentistry on Okinawa. Deny that plaintiff was further notified by said defendants, or either of them, that he did not have a one year contract, or that his employment could be terminated at any time at the will of said defendants. In this regard defendants allege that pursuant to the terms of said written contract, and particularly Section 2 thereof, said employment was terminable at any time at the will of said defendants. Deny that defendants, or either of them, refused to allow plaintiff to perform the duties of his employment, and in this regard, allege that plaintiff failed to perform the duties and conditions of his employment. Deny that plaintiff was discharged or his employment terminated without just cause, and in this regard, allege that plaintiff was discharged for cause, in accordance with the terms and provisions of said written contract.

VII.

Deny the allegations of paragraph X.

VIII.

Admit the allegations of paragraph XI except that defendants are without information or belief as to the place in the United States where plaintiff returned following the termination of his employment, and placing their denial on that ground, deny the allegations in regard to the place of return.

IX.

Deny the allegations of paragraphs XII and XIII.

As and for a Second Defense Defendants Allege as Follows:

I.

The complaint does not state facts sufficient to constitute a claim upon which relief can be afforded against defendants or each of them.

As and for a Third Defense Defendants Allege as Follows:

I.

On the 5th day of December, 1947, at Sausalito, California, plaintiff and defendants made and entered into that certain contract in writing hereinabove referred to. A true copy of said contract has heretofore been attached as "Exhibit A" to defendants' answer to plaintiff's original complaint, which answer was filed in this action on August 12, 1949. Defendants incorporate herein by reference said "Exhibit A" to their original answer. In accordance with the terms and provisions of said contract, plaintiff was transported to Okinawa. Thereafter, contrary to specific instructions given to plaintiff by defendants, and in violation of the terms and provisions of such contract, plaintiff conducted the private practice of dentistry while employed under the terms and provisions of said contract, and did demand and receive fees and gratuities from employees of defendants for dental services rendered

to such employees of defendants, all of which dental services were to be rendered without charge by plaintiff, in accordance with said terms and provisions of said contract.

II.

Plaintiff was informed and advised prior to the execution of said written contract that demand for, or acceptance of, any fees or gratuities by him for dental services rendered by him to employees of defendants would constitute grounds for discharge. Upon plaintiff's arrival in Okinawa he was further advised and warned that demand for, or acceptance of, any fees or gratuities would constitute grounds for discharge. Notwithstanding such advice and such warning and the provisions of said contract, plaintiff did demand, receive and accept fees and gratuities of employees of defendants for dental services thereafter, and in accordance with said terms and conditions of said written contract, plaintiff was discharged for cause.

III.

Defendants have at all times fully performed all the terms and conditions of said written contract on their part to be performed, and have paid the plaintiff in full any and all sums of money to which plaintiff may have been entitled in accordance with the terms and provisions of said written contract.

Wherefore, defendants pray that plaintiff take nothing by his action; that the action be dismissed

and that defendants have their costs and such other and further relief as may be proper in the premises.

LLOYD H. BURKE,

United States Attorney;

By /s/ GEORGE A. BLACKSTONE,

Assistant United States Attorney, Attorneys for Defendants.

Affidavit of mailing attached.

[Endorsed]: Filed July 28, 1953.

[Title of District Court and Cause.]

REQUEST FOR ADMISSIONS AND INTER-
ROGATORIES PROPOUNDED BY DE-
FENDANTS

Defendants request plaintiff within fifteen days after service of this request to admit, for the purpose of this action only, that the contract attached to defendants' answer to the original complaint in the above action as Exhibit A is a true and correct copy of the written contract between plaintiff and defendants alleged in paragraph VI of the amended complaint.

Defendants propound the following interrogatories to be answered by plaintiff under oath within fifteen days after the service hereof:

1. What is the name and position of each person who you claim made the misrepresentations alleged in your amended complaint?
2. At what particular place and on what date

was each of the alleged misrepresentations made to you?

3. Who was present at the time each of the alleged misrepresentations was made to you?

4. With reference to each alleged misrepresentation, state fully and completely each and every conversation, act and occurrence upon which you base your claim.

LLOYD H. BURKE,

United States Attorney;

/s/ GEORGE A. BLACKSTONE,

By GEORGE A. BLACKSTONE,

Assistant United States Attorney, Attorneys for
Defendants.

Affidavit of mailing attached.

[Endorsed]: Filed October 26, 1953.

[Title of District Court and Cause.]

ANSWERS OF PLAINTIFF TO INTERROGA-
TORIES PROPOUNDED BY DEFEND-
ANTS

Comes now Percy P. Davis, plaintiff above-named, and in response to the interrogatories numbered 1 to 4, both inclusive, propounded to him in the above-entitled action, makes the following answers:

Answer to Interrogatory 1:

George A. Gardner, personnel manager of Guy F. Atkinson Company and J. A. Jones Construction Company at New York City, New York;

Robert E. Doyle, personnel manager of Guy F. Atkinson Company and J. A. Jones Construction Company at Sausalito, California.

Answer to Interrogatory 2:

At New York City, New York, in November, 1947;

At Sausalito, California, on or about December 5, 1947.

Answer to Interrogatory 3:

The only person present at New York City, New York, at the time the alleged misrepresentations were made to me was, in addition to George A. Gardner and myself, my wife, Florence A. Davis.

At Sausalito, California, the persons present at the time the alleged misrepresentations were made to me were, in addition to Robert E. Doyle and myself, L. C. Fassett, a Mr. Keenan, whose first name I do not remember, and my wife, Florence A. Davis.

Answer to Interrogatory 4:

During the months of November and December, 1947, Guy F. Atkinson Company and J. A. Jones Construction Company advertised in several newspapers in New York City, New York, offering employment on the Island of Okinawa. The published advertisement also notified applicants for such employment to present themselves to George A. Gardner at New York State Employment Service, 87 Madison Avenue (Twenty-eighth Street), New York

City. The advertisement further provided for a one year contract with transportation furnished.

In reliance upon said advertisement my wife, Florence A. Davis, and I, then residing on Long Island, New York, conferred with Mr. George A. Gardner with respect to employment as dentist for myself and dental assistant, for my wife. I stated to Mr. Gardner that my wife and I could not accept the positions purely on a salary basis unless I would be allowed to engage in private practice. Mr. Gardner stated that no private fees could be permitted because of government regulations which forbade the use of government property for private purposes. I then suggested that I be allowed to use certain equipment of my own for such purpose. Mr. Gardner, who had been in contact with the Sausalito office of Atkinson-Jones, said that he could conceive of no objection on the part of the management to such arrangement, and that further details would be worked out with the office in Sausalito.

After arriving in Sausalito, California, and before signing the contract with Guy F. Atkinson Company and J. A. Jones Construction Company on December 5, 1947, my wife and I had a conference with Mr. Robert E. Doyle at his office in Sausalito. We discussed the conditions under which my wife and I had previously worked on other contract positions, and that on such previous positions we had been permitted to engage in private practice and to receive private fees for particular serv-

ices. I told Mr. Doyle, as I had previously told Mr. Gardner, that my wife and I could not accept the employment purely on a salary basis unless I would be allowed to engage in private practice. I also told Mr. Doyle that I would use my own equipment in my private practice. Mr. Doyle stated that the employees of his company were entitled to dental work of an emergency nature only, and that if they wanted other dental work done they would have to pay for such work. He told me that any work that I might do for any employee of his company, other than work of an emergency nature, would be between the patient and me, and that the patient would have to pay for such work. Mr. Doyle described the difficulties which had arisen between the previous dentist and management on Okinawa, wherein men who were treated were dissatisfied and unhappy with the type and standard of dental services rendered them. I assured Mr. Doyle that I guaranteed all my dental work unconditionally on the basis of "100% satisfaction or entire fee refunded." I also told Mr. Doyle that we had the necessary dental equipment and supplies ready for complete dental service and I requested permission for an extra weight allowance in shipping the equipment to Okinawa. He gave his approval for the extra weight shipment.

I asked Mr. Doyle for a definite contract setting forth the provisions with regard to private work, but he told me that it would not be possible to sign such special contract because only a general con-

tract was available for all employees. He stressed the fact before Mr. Fassett and Mr. Keenan that the contract with the employees called only for emergency dental work and that any work that we might do, other than work of an emergency nature, would be between the patient and myself.

.....,

Plaintiff.

Duly verified.

Receipt of copy acknowledged.

[Endorsed]. Filed December 1, 1953.

[Title of District Court and Cause.]

AFFIDAVIT ADMITTING MATTERS IN DEFENDANTS' REQUEST FOR ADMISSIONS

State of Oregon,
County of Multnomah—ss.

Percy P. Davis, being first duly sworn, deposes and says:

That he is the plaintiff in the above-entitled action. That said plaintiff was served with written notice by the defendants above named to admit the truth of the matters of fact in defendants' request for admissions and in answer thereto said plaintiff admits, for the purpose of this action only, that the contract attached to defendants' answer to the original complaint in the above action as Exhibit A is a true and correct copy of the written contract be-

tween plaintiff and defendants alleged in paragraph VI of the amended complaint.

/s/ PERCY P. DAVIS.

Subscribed and sworn to before me this 19th day of November, 1953.

[Seal] /s/ ELIZABETH M. MUNDORFF,
Notary Public in and for the County of Multnomah, State of Oregon.

My commission expires Feb. 10, 1956.

[Endorsed]: Filed December 1, 1953.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR
SUMMARY JUDGMENT

To: Plaintiff Percy P. Davis, and to G. H. Van Harvey, Esq., his Attorney:

You and each of you will please take notice that on Monday, the 21st day of December, 1953, at the hour of 9:30 a.m., or as soon thereafter as counsel may be heard, defendants will move the above-entitled Court in Room 258 Federal Post Office and Court House Building, Seventh and Mission Streets, San Francisco, California, for summary judgment on the following grounds:

(1) That there is no triable issue of fact and that it affirmatively appears from the records and

files in the action that plaintiff has failed to state a claim upon which relief can be granted;

(2) That the basis of Federal jurisdiction does not affirmatively appear.

This motion will be based upon this Notice, the attached Memorandum of Points and Authorities, and all the records and files in the action.

LLOYD H. BURKE,
United States Attorney;

By /s/ GEORGE A. BLACKSTONE,
Assistant United States Attorney, Attorneys for
Defendants.

Affidavit of mailing attached.

[Endorsed]: Filed December 9, 1953.

[Title of District Court and Cause.]

ORDER GRANTING MOTION OF
DEFENDANTS FOR SUMMARY JUDGMENT

Heretofore* the court granted defendants' motion for dismissal, without prejudice to the filing of an amended complaint for damages for fraud or deceit. Such an amended complaint was filed.

Defendants have now moved for summary judgment in their favor. The ground of the motion is that plaintiff's answers to interrogatories pro-

*See order of July 17, 1952.

pounded by defendants show that plaintiff has no cause of action as alleged in the amended complaint.

Plaintiff's answers to interrogatories 1, 2 and 3 affirmatively show that the written contract executed by the parties was not induced by any fraud or misrepresentation of any kind by the defendants.

Summary judgment may enter in favor of defendants.

Dated: December 28, 1953.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed December 29, 1953.

In the United States District Court for the Northern District of California, Southern Division
Civil Action No. 28816

PERCY P. DAVIS,

Plaintiff,

vs.

GUY F. ATKINSON COMPANY, a Corporation,
et al.,

Defendants.

SUMMARY JUDGMENT

The motion for summary judgment of defendants coming on regularly to be heard on December 28, 1953, upon notice of motion duly filed and served.

and the Court having considered and granted said motion, by order filed on December 29, 1953,

It Is Ordered, Adjudged and Decreed that plaintiff take nothing by his action, that the same be and hereby is dismissed, and that judgment be entered for defendants with costs.

Dated: January 4th, 1954.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed January 4, 1954.

Entered January 5, 1954.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Percy P. Davis, plaintiff and appellant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the summary judgment entered in this action on the 5th day of January, 1954.

Dated this 1st day of February, 1954.

/s/ G. H. VAN HARVEY,
Attorney for Plaintiff and Appellant Percy P.
Davis.

[Endorsed]: Filed February 2, 1954.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing documents, listed below, are the originals filed in this Court in the above-entitled case and that they constitute the record on appeal herein:

Complaint for damages for breach of contract.
Answer.

Interrogatories propounded by defendants to plaintiff under Rule 33 Federal Rules of Civil Procedure.

Answers of plaintiff to interrogatories propounded by defendants.

Interrogatories propounded by defendants to plaintiff under Rule 33 Federal Rules of Civil Procedure.

Request for admission of genuineness of documents, under Rule 36.

Motion for Summary Judgment.

Order granting motion for judgment of dismissal.

Notice of motion for leave to file amended complaint.

Amended complaint for damages.

Order granting motion for leave to file amended complaint.

Answer to amended complaint for damages.

Request for admissions and interrogatories propounded by defendants.

Answers of plaintiff to interrogatories propounded by defendants.

Affidavit admitting matters in defendants' request for admissions.

Notice of motion for summary judgment.

Order granting motion of defendants for summary judgment.

Summary Judgment.

Notice of appeal.

Bond for costs on appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 10th day of March, 1954.

[Seal] C. W. CALBREATH,
Clerk;

By /s/ WM. C. ROBB,
Deputy Clerk.

[Endorsed]: No. 14262. United States Court of Appeals for the Ninth Circuit. Percy P. Davis, Appellant, vs. Guy F. Atkinson Company, a Corporation, and J. A. Jones Construction Company, a Corporation, Appellees. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed March 10, 1954.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14262

PERCY P. DAVIS,

Plaintiff and Appellant,

vs.

GUY F. ATKINSON COMPANY, a Corporation,
and J. A. JONES CONSTRUCTION COM-
PANY, a Corporation,

Defendants and Respondents.

STATEMENT OF POINTS ON APPEAL

Plaintiff and appellant herewith presents the
points upon which he intends to rely on appeal:

1. That the Court erred in allowing the motion
of defendants for summary judgment.

2. That the Court erred in entering judgment
that plaintiff take nothing by his amended com-
plaint.

Dated March 19, 1954.

/s/ G. H. VAN HARVEY,

Attorney for Plaintiff and
Appellant.

Copy of the within Statement of Points on Ap-
peal is hereby admitted this 19th day of March, 1954.

/s/ LLOYD H. BURKE,

United States Attorney;

/s/ GEO. A. BLACKSTONE,

Deputy United States
Attorney.

[Endorsed]: Filed March 19, 1954.

No. 14,262

United States Court of Appeals
For the Ninth Circuit

PERCY P. DAVIS,

Appellant,

VS.

GUY F. ATKINSON COMPANY, a Corporation,
and J. A. JONES CONSTRUCTION COMPANY, a Corporation,

Appellees.

APPELLANT'S OPENING BRIEF.

G. H. VAN HARVEY,

1028 Mills Building, San Francisco 4, California,

Attorney for Appellant.

FILED

JUN 10 1954

PAUL P. O'BRIEN
CLERK

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United States Court of Appeals For the Ninth Circuit

PERCY P. DAVIS,

Appellant,

vs.

GUY F. ATKINSON COMPANY, a Corporation,
and J. A. JONES CONSTRUCTION COMPANY, a Corporation,

Appellees.

APPELLANT'S OPENING BRIEF.

This is an appeal to the United States Court of Appeals for the Ninth Circuit, from a summary judgment in favor of appellees made and entered by the United States District Court for the Northern District of California, Southern Division.

JURISDICTION.

This cause was commenced by the filing of a complaint on behalf of appellant to recover damages from the appellees for the breach of a contract of employment (TR 3). Upon the entry of an order of the District Court granting appellees' motion for sum-

mary judgment (TR 32), appellant asked for leave to file an amended complaint, which leave was granted by the District Court. By his amended complaint (TR 33), appellant seeks to recover damages for fraud or misrepresentations of appellees in inducing appellant to enter appellees' employment and in procuring the execution of said contract of employment.

Appellees moved for summary judgment on the principal ground that there was no triable issue of fact in that it affirmatively appeared from the records and files in the action that appellant had failed to state a claim upon which relief could be granted (TR 51). The motion was granted (TR 52) and summary judgment was thereupon entered in favor of appellees (TR 53). Appellant thereupon filed notice of appeal from that judgment (TR 54).

The District Court had jurisdiction of the action by virtue of the provisions of Section 1332 of Title 28 U.S.C.A. (formerly 28 U.S.C.A., Section 41) (TR 3, 9).

The United States Court of Appeals for the Ninth Circuit has jurisdiction of said appeal by virtue of the provisions of Sections 41, 1291, 1294, and 2107 of Title 28, U.S.C.A., notice of appeal (TR 54) having been filed within thirty days from the entry of the summary judgment.

This Court has jurisdiction over this appeal from the judgment of the District Court granting the summary judgment.

Federal Rules of Civil Procedure, Rule 56(b);

Bee Machine Co. v. Freeman, 131 Fed. (2d) 190, affirmed 319 U.S. 448, 63 S.Ct. 1146, 87 L. Ed. 1509, rehearing denied 320 U.S. 809, 64 S.Ct. 27, 88 L.Ed. 489.

STATEMENT OF THE CASE.

Appellees had been awarded a contract with the War Department of the United States for the performance of certain construction work on the Island of Okinawa and at other locations in the area under the jurisdiction of the Western Ocean Division of the United States Engineer Corps. They employed a large number of workers on said Island of Okinawa. The contract of employment in general use for work on said Island provided, so far as necessary to note here, that board, lodging, medical services, and *dental care of an emergency nature only*, would be furnished to appellees' employees at the site of the work to the extent authorized by the Contracting Officer, and at a charge approved by him, which charge would not exceed the sum of \$1.50 per day.

Prior to his employment by appellees appellant had been a dentist practicing his profession and maintaining an office in New York City, and was a member of and employed by the Board of Health of that City (TR 33).

During the months of November and December, 1947, appellees advertised in several newspapers in New York City offering employment on the Island

of Okinawa. The published advertisement notified all applicants for such employment to present themselves to George A. Gardner, personnel manager of appellees, at New York City. The advertisement further provided for a one year contract with transportation furnished (TR 47), and also that limited dental care would be furnished without charge (TR 34, 48).

Appellant and his wife conferred with said George A. Gardner with respect to employment as dentist for himself and dental assistant for his wife. Appellant stated to Mr. Gardner that he and his wife could not accept the positions purely on a salary basis unless he would be allowed to engage in private practice (TR 48). Having been advised by Mr. Gardner that no private fees could be permitted because of government regulations which forbade the use of government property for private purposes, appellant suggested that he be allowed to use certain equipment of his own for such purpose. Mr. Gardner stated that he could conceive of no objection to such arrangement and that further details would be worked out with the office in Sausalito, California (TR 48). After arriving in Sausalito, California, appellant and his wife conferred with Mr. Robert E. Doyle, personnel manager of appellees at that place. Appellant likewise told Mr. Doyle that he and his wife could not accept the employment purely on a salary basis unless he would be allowed to engage in private practice; appellant informed Mr. Doyle of the conditions under which he and his wife had previously worked on other contract positions, and that on such previous positions

they had been permitted to engage in private practice and to receive private fees for particular services. Appellant also told Mr. Doyle that he would use his own equipment in such private practice (TR 48, 49). Mr. Doyle stated to appellant that the employees of appellees were entitled to dental work of an emergency nature only, and that if they wanted other dental work done they would have to pay for such work. He told appellant that any work that he might do for any employee, other than work of an emergency nature, would be between the patient and appellant, and that the patient would have to pay for such work (TR 49). Appellant also told Mr. Doyle that he had the necessary dental equipment and supplies ready for complete dental service and he requested permission for an extra weight allowance in shipping the equipment to Okinawa. Mr. Doyle gave his approval for the extra weight shipment (TR 49).

Appellant asked Mr. Doyle for a definite contract setting forth the provisions with regard to private work, but appellant was told that it would not be possible to sign such special contract because only a general contract was available for all employees. Mr. Doyle stressed the fact that the contract with the employees called only for emergency dental work and that any other work would be between the patient and appellant (TR 49, 50).

Thereafter and on December 5, 1947, appellant, relying upon the representations so made by appellees, signed and executed a written contract (TR

16, 17), purporting to hire and employ appellant as a dentist at the site of the construction work on said Island of Okinawa (TR 36). Appellant thereupon shipped to said Island a complete operative, prosthetic, crown and bridge kits and engine, all of which equipment had no relation to emergency dental work. Appellees authorized a special weight allowance in shipping said equipment. Appellant and his wife went to Okinawa where they immediately entered the employ of appellees (TR 36, 37).

After arriving on said Island of Okinawa appellant was notified by appellees that he could not engage in the private practice of dentistry, and he was prevented by appellees from engaging in such private practice. Appellant was also notified that he did not have a one year contract but that his employment was terminable at any time at the will of appellees (TR 37, 38). Appellant was thereupon discharged and his employment terminated (TR 38).

Appellant and his wife returned to the United States at their own cost, and appellant was compelled to and did pay for his subsistence until his return to New York City, and his expenses of transportation and of the transportation of his dental equipment to New York City (TR 38, 39).

Appellant by his amended complaint claims damages in the total sum of \$43,850.00 (TR 39, 40).

Following the filing of appellant's amended complaint (TR 33) appellees filed their answer thereto (TR 40). Appellees then filed and served request for

admissions and also propounded interrogatories to be answered by appellant (TR 45). Appellant filed his affidavit admitting certain matters (TR 50), and filed his answers to the interrogatories propounded to him (TR 46).

Appellees then moved for summary judgment (TR 51), which motion was granted by the District Court (TR 52) and summary judgment was thereupon entered in favor of appellees and against appellant that appellant take nothing by his action, that the same be dismissed and that judgment be entered for appellees with costs (TR 53). From this judgment this appeal is taken (TR 54).

There is only one issue involved on this appeal: Was appellant induced to enter into the employment of appellees by reason of the representations of appellees that the contract would continue for one year, that the services which he was to perform under the contract of employment would be limited to dental services of an emergency nature only, and that he could otherwise engage in the private practice of dentistry. Appellant will divide that issue into two parts:

1. The representations made by appellees constituted actionable fraud;

2. Appellant was not precluded from relying on the representations of appellees by reason of any contract provisions, where appellant was induced to enter into the contract by reason of such representations.

SPECIFICATION OF ERRORS.

1. The District Court erred in finding that appellant had no cause of action for fraud.

2. The District court erred in finding that the written contract executed by the parties was not induced by any fraud or misrepresentation of any kind of appellees.

3. The District Court erred in allowing the motion of appellees for summary judgment.

SUMMARY OF ARGUMENT.

Appellant contends that a summary judgment should not be entered unless the pleadings, depositions and admissions on file show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

We will show that the allegations of the amended complaint, the admissions and depositions on file positively show that appellant was induced to enter into the employment of appellees and to execute the written contract of employment through the false representations of appellees; that appellees' liability for fraud could not be restricted by any provisions in the written contract; and that appellees were bound by the acts of their officers and agents.

ARGUMENT.**I.**

SUMMARY JUDGMENT SHOULD NOT BE ENTERED UNLESS THE PLEADINGS, DEPOSITIONS AND ADMISSIONS SHOW THAT THERE IS NO GENUINE ISSUE AS TO ANY MATERIAL FACT.

In passing upon a motion for summary judgment it is not the function of the Court to decide issues of fact but only to determine whether there are such issues to be tried.

Lane v. Greyhound Corporation, 13 F.R.D. 178.

The decisions are unanimous in holding that, in considering a motion for summary judgment, the Court should take the view most favorable to the party against whom the motion is directed, giving the party the benefit of all favorable inferences that may reasonably be drawn from the evidence, and resolving all doubts as to the existence of a genuine issue against the moving party.

Toebelman v. Missouri-Kansas Pipe Line Co.,
130 Fed. (2d) 1016;

Ramsouer v. Midland Valley Railroad Co., 135
Fed. (2d) 101;

Sarnoff v. Ciaglia, 165 Fed. (2d) 167;

Lane v. Greyhound Corporation, 13 F.R.D. 178.

“A summary judgment is to be entered in a case, if, but only if, the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. Rule

56(c) Federal Rules of Civil Procedure. A summary judgment upon motion therefor by a defendant in an action should never be entered except where the defendant is entitled to its allowance beyond all doubt. To warrant its entry the facts conceded by the plaintiff, or demonstrated beyond reasonable question to exist, should show the right of the defendant to a judgment with such clarity as to leave no room for controversy, and they should show affirmatively that the plaintiff would not be entitled to recover under any discernible circumstances.”

Traylor v. Black, Sivalls & Bryson, Inc., 189 Fed. (2d) 213.

It is the position of appellant that there was a genuine issue of fact which should have been tried by the Court or a jury, and therefore the summary judgment was improper.

II.

THE ALLEGATIONS OF THE AMENDED COMPLAINT, ADMISSIONS AND DEPOSITIONS SHOW THAT APPELLANT WAS INDUCED TO ENTER INTO THE EMPLOYMENT OF APPELLEES AND TO EXECUTE THE CONTRACT OF EMPLOYMENT THROUGH THE FALSE REPRESENTATIONS OF APPELLEES.

The amended complaint and appellant's answers to the interrogatories propounded to him show that appellant and his wife, in response to advertisements appearing in certain New York newspapers, conferred with appellees' New York representative as to

possible employment of appellant as dentist and of his wife as his dental assistant (TR 33, 34, 48): Appellant particularly stated at that time that he and his wife could not accept the positions on a salary basis only unless he would be allowed to engage in the private practice of dentistry. After being informed that such employment could be arranged, appellant and his wife went to Sausalito, California, where they conferred with appellees' personnel manager (TR 35, 36, 48). During said conference appellant again stated that he and his wife could not accept the employment purely on a salary basis unless appellant would be allowed to engage in private practice, in which private practice he would use his own equipment. Appellees' personnel representative then stated to appellant that all employees were entitled to dental work of an emergency nature only, and as stated by appellant in his answers to the interrogatories:

"I asked Mr. Doyle for a definite contract setting forth the provisions with regard to private work, but he told me that it would not be possible to sign such special contract because only a general contract was available for all employees. He stressed the fact before Mr. Fassett and Mr. Keenan that the contract with the employees called only for emergency dental work and that any work that we might do, other than work of an emergency nature, would be between the patient and myself." (TR 49, 50.)

As the result of their conference the parties executed the written contract of December 5, 1947 (TR

16, 17) which contract provided in paragraph 7 thereof as follows:

“Board, lodging, medical services, and *dental care of an emergency nature only*, will be furnished by the Contractor at the site of the work to the extent authorized by the Contracting Officer, and at a charge approved by him, which charge shall not exceed the sum of One Dollar and Fifty Cents (\$1.50) per day.” (Italics ours) (TR 16, 17).

In complete reliance upon the representations and statements of appellees that appellant could engage in private practice and that his employment would continue for not less than one year, appellant shipped his equipment to Okinawa, for which shipment appellees had authorized a special weight allowance (TR 36).

At no time during appellant's interviews in New York or California was he or his wife informed that the contract was one that could be terminated at any time at the will of appellees, or that he could not engage in the private practice of dentistry, or that there were any rules or regulations of the United States Government prohibiting such private practice, other than appellant could not use government equipment in such private practice. Appellant and his wife were led to believe otherwise.

There can be no doubt that the statements or representations made by appellees under the circumstances of this case constituted actionable fraud. It is the only

inference that reasonable minds can make from the facts shown by the pleadings and the depositions.

Appellees, with full knowledge that appellant would not consent to the employment unless he could engage in private practice for at least one year, nevertheless positively and intentionally represented to appellant that he could so engage, and thereby induced him to accept the employment and to sign the written contract.

All the necessary elements of fraud have been established in this case.

Actual fraud consists in the suggestion, as a fact, of that which is not true, by one who does not believe it to be true; or the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true; or the suppression of that which is true, by one having knowledge or belief of the fact.

Section 1572, Civil Code of California.

Constructive fraud consists in any breach of duty which, without an actual fraudulent intent, gains an advantage to the person in fault, or anyone claiming under him, by misleading another to his prejudice.

Section 1573, Civil Code of California.

“It is not necessary, to constitute a fraud, that a man who makes a false statement should know precisely that it is false. It is enough if it be false, and if he made it recklessly, and without an honest belief in its truth, or without reasonable ground for believing it to be true, and be

made deliberately and in such a way as to give the person to whom it is made reasonable ground for supposing that it was meant to be acted upon and has been acted upon by him accordingly.”

Cooper v. Schlesinger, 111 U. S. 148, 4 S.Ct. 360, 28 L. Ed. 382.

Thus when appellees, through their personnel manager, stated to appellant that he could engage in the private practice of dentistry, knowing full well that such statement was not true, they were guilty of actual fraud. The law in such case supplies the fraudulent intent to deceive. And even if appellees had not fraudulently intended to deceive appellant, they were guilty of constructive fraud in negligently and carelessly making such statement or representation.

Hayter v. Fulmor, 92 Cal.App. (2d) 392, 206 Pac. (2d) 1101.

That appellees knew that the representation was false is shown by the deceptive answers given to appellant's several inquiries regarding his right to engage in private practice, and other untrue or misleading statements of appellees during the course of the interviews with appellant. The conduct of appellees clearly showed an intent to deceive appellant. They knew that appellant did not want to enter their employment unless he could engage in private practice during the full term of his employment. Except for the representation made by appellees that he could so engage appellant would not have entered

appellees' employment or executed the written contract.

"But a representation need not be a direct lie in order to constitute remediable fraud; the false representation may consist in a deceptive answer, or any other indirect but misleading language. No hard and fast rule can be laid down as to what constitutes a fraudulent representation in any given case, since this depends upon the peculiar circumstances and conditions involved."

Benner v. Hooper, 112 Cal.App. 53, 296 Pac. 660.

When considered in connection with all the facts in the case, the sale of appellant's practice in New York City, his resignation from the Board of Health of that City, the sale of his automobile and furniture, the shipment of his dental equipment to Okinawa, there can be no doubt that the representations, made by appellees as claimed by appellant, were material as an inducement to enter appellees' employment and to execute the contract of employment, and that upon the facts alleged in the amended complaint and shown in the answers to the interrogatories appellant is entitled to have the issues submitted to the Court or a jury.

As to the promise of employment for the period of one year as shown by the published advertisements in the New York City papers, appellant was justified in relying upon such statement and representation without further independent investigation on his own.

MacDonald v. DeFremery, 168 Cal. 189, 142 Pac. 73.

The rule that one accepting an instrument or signing a contract, without reading it or having it read, will not be heard to say that he was ignorant of its contents, does not apply, when an actual fraud has been committed and the signature obtained by misrepresentations.

Mardis v. Miller (C.C.A. 8) 241 Fed. 470;

Security-First National Bank v. Earp, 19 Cal. (2d) 774, 122 Pac. (2d) 900.

Fraudulent representations, by which a party is induced to enter into a contract to his damage, may be established by parol evidence, even though the written instrument purports to contain the entire agreement between the parties.

Hunt v. M. L. Field, Inc., 202 Cal. 701, 262 Pac. 730.

III.

APPELLEES' LIABILITY FOR FRAUD CANNOT BE RESTRICTED BY THE PROVISION OF THE WRITTEN CONTRACT THAT IT CONSTITUTES THE ENTIRE AGREEMENT AND THAT NO PROMISES OR UNDERSTANDINGS HAVE BEEN MADE OTHER THAN THOSE STATED THEREIN.

Section 22 of the contract between appellant and appellees provides:

“The employee certifies to the contractor that he has read the foregoing agreement and that he fully understands its terms and conditions, and further certifies that the foregoing terms and conditions constitute his entire agreement with the employer, and that no promises or understandings have been made other than those stated

above; and it is specifically agreed by the parties hereto that this agreement shall be subject to modification only by written instrument signed by both the contractor and the employee."

It is a fundamental principle of law that a party cannot contract against liability for his own fraud. Fraud which enters into the making of the contract cannot be excluded from the reach of the law by any formal provision inserted in the contract itself.

The provision contained in paragraph 22 of the contract did not preclude appellant from showing that the contract was procured through fraud.

Blackwell v. Thomason, 84 Cal.App. 784, 258 Pac. 724;

Mooney v. Cyriaks, 185 Cal. 70, 195 Pac. 192;

Whitting v. Squeglia, 70 Cal.App. 108, 233 Pac. 986.

There is no affidavit of appellees on file denying the authority of Robert E. Doyle to employ appellant or that Doyle was not acting within the scope of his authority in making the representations which induced appellant to enter into the contract of employment. We believe that it may fairly be inferred from the pleadings and depositions that Doyle was in complete charge of appellees' employment or personnel department, with authority to employ such help as appellees required under their contract with the War Department. There is, therefore, in this case no question of appellees' personnel representative violating his instructions or exceeding his authority. His authority was never denied.

It is clear that it was within Mr. Doyle's duties as manager of appellees' personnel department to discuss with all applicants for employment the terms and conditions of such employment. Appellees must therefore be held liable for the false representations made by their personnel manager to appellant. The rule is stated in the Restatement of the Law of Agency, Section 261, as follows:

"A principal who puts an agent in a position that enables the agent, while apparently acting within his authority, to commit a fraud upon third persons is subject to liability to such third persons for the fraud."

In such case the liability of the principal is based upon the fact that the agent's position facilitates the consummation of the fraud, in that from the point of view of the third person the transaction seems regular on its face and the agent appears to be acting in the ordinary course of the business confided to him.

Rutherford v. Rideout Bank, 11 Cal. (2d) 479, 80 Pac. (2d) 978.

The record supports the contention of appellant that Robert E. Doyle was the agent of appellees and acted within the scope of his authority in his transaction with appellant.

CONCLUSION.

It is submitted that the pleadings, depositions and admissions on file in this case show that there exists a genuine issue of fact, and therefore it was error for the District Court to grant appellees' motion for summary judgment, and the summary judgment against appellant should be reversed.

Dated, San Francisco, California,

June 7, 1954.

Respectfully submitted,

G. H. VAN HARVEY,

Attorney for Appellant.

No. 14,262

United States Court of Appeals
For the Ninth Circuit

PERCY P. DAVIS,

Appellant,

vs.

GUY F. ATKINSON COMPANY, a corporation,
and J. A. JONES CONSTRUCTION
COMPANY, a corporation,

Appellees.

APPELLEES' REPLY BRIEF.

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FILED

JUL 22 1954

PAUL P. O'BRIEN
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**United States Court of Appeals
For the Ninth Circuit**

PERCY P. DAVIS,

Appellant,

VS.

GUY F. ATKINSON COMPANY, a corporation,
and J. A. JONES CONSTRUCTION
COMPANY, a corporation,

Appellees.

APPELLEES' REPLY BRIEF.

JURISDICTION.

Appellees deny that the District Court had jurisdiction of this action. Appellant attempts to base jurisdiction on diversity of citizenship, 28 U.S.C. §1332. However, there is no allegation in either the original complaint (R. 3-9) or the amended complaint (R. 33-40) as to the state of which appellant was a *citizen* at the time of commencement of the action. All that is alleged is that appellant "during all of the times herein mentioned * * * was a dentist duly authorized to practice his profession and maintaining an office in the City of New York City, State of New York, and residing in said City of New York City, and * * *

was a member of the Board of Health of said city.” (Complaint II, R. 3; Amended Complaint I, R. 33) Allegations of *residence* are not tantamount to allegations of citizenship in establishing diversity jurisdiction.

Realty Holding Co. v. Donaldson, 268 U.S. 398, 399, 45 S.Ct. 521 (1925);

Steigleder v. McQuesten, 198 U.S. 141, 143, 25 S.Ct. 616 (1905);

Atchison, T. & S. F. Ry. Co. v. Frederickson, 177 Fed. 206 (9th Cir. 1910);

Int’l Bank & Trust Co. v. Scott, 159 Fed. 58 (5th Cir. 1908);

Jeffcott v. Donovan, 135 F.2d 213 (9th Cir. 1943);

Keene Lumber Co. v. Leventhal, 165 F.2d 815, 818 (1st Cir. 1948).

From all that appears, appellant may well have been a *citizen* of the State of California at the time the action was commenced and thus there would be no diversity jurisdiction since defendants are California corporations. (Complaint III, R. 4; Answer III, R. 9; Amended Complaint II, R. 33; Answer II, R. 40) Rule 8(a)(1) of the Federal Rules of Civil Procedure requires that the complaint contain a short and plain statement of the grounds upon which the trial court’s jurisdiction depends. This rule was not complied with. On the record before this Court there is no basis for determining the existence or non-existence of diversity jurisdiction and for that reason the appeal should be dismissed. No federal question is involved.

STATEMENT OF THE CASE.

Appellant originally commenced this action seeking only to recover for alleged breach of his employment contract. (R. 3) Section 2 of the contract (R. 16) provides as follows:

“The term of this agreement shall be for the period during which the Contractor desires the services of the Employee in connection with construction work in the Western Ocean Division; provided, that after twelve (12) months continuous employment from the date of this agreement, the employee may terminate his employment hereunder by giving the Contractor written notice specifying the date on which he desires to terminate his employment, which date shall not be less than fifteen (15) days after the date of delivery of notice to the Contractor.”

Section 10 of the contract (R. 17) provides in part as follows:

“If, prior to the completion of twelve (12) months’ service hereunder, the Employee quits or this agreement is terminated by the Contractor for cause, all wages, travel allowance and other payments shall cease as of the time of quitting or discharge, and the Employee shall thereafter be liable for and shall pay his own costs of living and his own return transportation costs and expenses, and no further obligation shall exist on the part of the Contractor to the Employee. * * *”

The District Court dismissed the original complaint for lack of jurisdiction with leave to amend. It had been stipulated that the cost to appellant of return

transportation was less than \$3,000 and the Court determined that such return transportation was the most that appellant could recover under the contract even if he proved he had been discharged without cause. R. 32) Appellant has not appealed from that ruling of the District Court.

The amended complaint attempts to state a claim against appellees for damages for alleged fraudulent representations which induced appellant to enter into the written employment contract. The acts, occurrences and representations upon which appellant's claim is based, as specified in his answer to Interrogatory No. 4 (R. 47-50), are as follows:

(1) Newspaper advertisements in New York City in November and December, 1947, offering employment with appellees in Okinawa under a one-year contract with transportation furnished. (R. 47-48)

(2) Statement by George A. Gardner (appellees' personnel manager in New York City) in New York City in November, 1947 that he could conceive of no objection on the part of management to appellant's engaging in private practice on Okinawa if appellant's own equipment were used and that further details would be worked out with the office in Sausalito, California. (R. 48)

(3) Statement by Robert E. Doyle (appellees' personnel manager at Sausalito, California) on December 5, 1947 that company employees were entitled to dental work of an emergency nature only and that if they wanted other dental work done they would have to ar-

range for it with appellant and pay him for such work. Mr. Doyle gave appellant permission for an extra weight allowance in shipping to Okinawa dental equipment and supplies necessary for complete dental service. (R. 49)

Appellant also states in his answer to Interrogatory No. 4 as follows:

"I asked Mr. Doyle for a definite contract setting forth the provisions with regard to private work, but he told me that it would not be possible to sign such special contract because only a general contract was available for all employees. He stressed the fact before Mr. Fassett and Mr. Keenan that the contract with the employees called only for emergency dental work and that any work that we might do, other than work of an emergency nature, would be between the patient and myself. (R. 49-50)

Section 22 of the employment contract provides as follows:

"SECTION 22. Certification by Employee.

"THE EMPLOYEE CERTIFIES TO THE CONTRACTOR THAT HE HAS READ THE FOREGOING AGREEMENT AND THAT HE FULLY UNDERSTANDS ITS TERMS AND CONDITIONS AND FURTHER CERTIFIES THAT THE FOREGOING TERMS AND CONDITIONS CONSTITUTE HIS ENTIRE AGREEMENT WITH THE EMPLOYER, AND THAT NO PROMISES OR UNDERSTANDINGS HAVE BEEN MADE OTHER THAN THOSE STATED ABOVE; AND IT IS SPECIFICALLY

AGREED BY THE PARTIES HERETO THAT THIS AGREEMENT SHALL BE SUBJECT TO MODIFICATION ONLY BY WRITTEN INSTRUMENT SIGNED BY BOTH THE CONTRACTOR AND THE EMPLOYEE.” (R. 17)

The amended complaint alleges that each of the representations relied upon by appellant was false and he was induced thereby to execute the written employment contract; that appellees knew that his employment was terminable at will and that under the rules and regulations of the United States applicable to Okinawa appellant could not engage in private dental practice there. (Amended Complaint VIII, R. 37) Appellant further alleges that after arriving in Okinawa he was notified by appellees that he could not engage in private practice and that his employment was terminable at will; that he was prevented from engaging in private practice; and that his employment was terminated without just cause and against his will. (Amended Complaint IX, R. 37-38) Appellant seeks general damages of \$25,000 and special damages of \$18,850. (R. 39-40)

QUESTION PRESENTED.

Does appellant have a claim for fraud inducing the execution of a written employment contract where the contract itself stipulates against prior oral representations and otherwise reveals the falsity of prior misrepresentations, if any?

SUMMARY OF ARGUMENT.

There is no triable issue of fact. The stipulation in appellant's employment contract against promises or understanding other than those contained in the written contract itself is a complete bar to appellant's action for damages. Such a provision in a contract protects a principal from liability for damages for the unauthorized misrepresentations of his agents even though it does not preclude rescission of the contract. The contract itself clearly specified that the term of employment was at the will of the employer rather than for one year certain. The contract also warned appellant that his time was not his own and that the rules and regulations of the United States applicable to Okinawa superseded the contract. The falsity of any earlier misrepresentation in regard to the employment term and engaging in private practice was thus revealed to him by the contract itself. Furthermore, appellant *requested, but was refused*, a special contract that would have specifically authorized him to engage in private dental practice. Appellant can not now be heard to complain that he relied on oral promises which he knew the employer refused to agree to in the written contract.

ARGUMENT.**I. APPELLEES ARE NOT LIABLE FOR THE UNAUTHORIZED MISREPRESENTATIONS OF THEIR AGENTS BECAUSE OF THE STIPULATION AGAINST SUCH REPRESENTATIONS IN THE WRITTEN EMPLOYMENT CONTRACT.**

Section 22 of appellant's employment contract provides in bold face type that the writing contains his *entire* agreement with appellees AND THAT NO PROMISES OR UNDERSTANDINGS HAVE BEEN MADE OTHER THAN THOSE STATED IN THE WRITING. (R. 17) Similar stipulations in written contracts have been before the California courts on numerous occasions. It is well established in California that such a provision in a contract protects a principal from liability for damages for the oral misrepresentations of his agent although it does not preclude rescission of the contract by timely notice and offer of restitution.

In *Gridley v. Tilson*, 202 Cal. 748, 262 Pac. 322 (1927), the California Supreme Court was confronted with a provision in a contract for the sale of stock which read, "It is understood that no representative has any power to change, modify or make any other terms or representations whatsoever than those herein stated, and that the representative is acting as special agent and all representations not herein set out are by me deemed waived." The Court upheld the validity of this stipulation and stated,

"It is contended by the plaintiff that the quoted provision of the subscription contract limited the authority of the agents to make only the representations set out in the contract; that the defend-

ant had notice of the limitation and that evidence of any other representations made by the agents should not have been received. This contention must be sustained. While the Civil Code, section 1625, provides that a written contract supercedes all negotiations it has always been the law that fraud in the inducement of a contract may be shown. *A well-settled exception, however, is the case where the party seeking to rely on fraudulent representations of an agent had notice of the limitation on the agent's authority to make representations. Therefore a principal is bound only by the representations embodied in the written contract where a provision in the contract notified the prospective purchaser that the agent's authority went no further.* (Fidelity etc. Co. v. Fresno Flume Co., 161 Cal. 466 [37 L.R.A. (N.S.) 322, 119 Pac. 646]; Pease v. Fitzgerald, 31 Cal. App. 727 [161 Pac. 506]; Tockstein v. Pacific Kissel Kar Branch, 33 Cal. App. 262 [164 Pac. 906]; Munn v. Anthony, 36 Cal. App. 312 [171 Pac. 1082]; Schuster v. North American Hotel Co., 106 Neb. 672 [184 N.W. 136, 186 N.W. 87]; Northern Assur. Co. v. Grand View Building Assn., 183 U.S. 308 [46 L. Ed. 213, 22 Sup. Ct. Rep. 33].) In the case of Pease v. Fitzgerald, *supra*, the rule was applied under circumstances almost identical with the circumstances in the present case. Defendant, however, attempts to escape the effect of the settled rule of these cases by testifying that he did not have his glasses with him at the time he signed the subscription contract and gave the notes and therefore he did not read the contract nor the provision referred to. But this cannot afford him an excuse in the ab-

sence of a showing that he was prevented by the agent from reading the limiting clause or was otherwise tricked into signing the document without reading it. He made no request to have the contract read to him. In addition it was in evidence that he had previously signed similar contracts with the same company in subscribing for 3,000 shares of its stock.” (202 Cal. at 751-52) (Emphasis supplied.)

The doctrine announced in the *Gridley* case has subsequently been limited to an action for *damages* by the decision in *Speck v. Wylie*, 1 C.2d 625, 36 P.2d 618 (1934). In the latter case a purchaser of real estate sought to recover installment payments after giving the seller timely notice of rescission and offering to restore the premises. It appeared that the purchaser had been induced to buy the property by the misrepresentations made by the seller’s agent. The sales contract provided as follows:

“It is understood and agreed that this contract contains all the covenants, stipulations and provisions agreed upon by the parties hereto and no agent of either party to this contract has authority to alter or change the terms hereof and neither party is or shall be bound by any statement or representation not in conformity herewith.”

Despite the sweeping language in *Gridley v. Tilson, supra*, the California Supreme Court permitted the defrauded party to rescind the contract and limited the effect of the quoted stipulation to an action by the defrauded party for *damages* (which is the nature of

the instant case by appellant). After quoting Sections 259 and 260 of the Restatement of Agency, the Court said,

“Without attempting further elaboration we therefore announce that we are in accord with the above statements of the rule which will, all other things being favorable to the complaining party, allow him to rescind and to pursue the principal far enough to secure a return of the consideration paid. *But an action for fraud and deceit will not be allowed him under such conditions.* The doctrine of Gridley v. Tilson, supra, and such appellate court cases as may have followed it, should be limited in its application by the exception hereinabove set forth.” (1 C.2d at 628) (Emphasis supplied.)

In *Harnischfeger Sales Corp. v. Coats*, 4 C.2d 319, 48 P.2d 662 (1935), defendant counterclaimed for damages for fraud in connection with a conditional sales contract for the purchase of a power shovel. The contract provided, “it is hereby further declared, agreed and understood that there are no prior writings, verbal negotiations, understandings, representations or agreements between the parties not herein expressed.” The Court said,

“It seems clear that this stipulation limits the authority of the agent to make representations, and purports to absolve the principal from all responsibility therefor. The question is whether such a stipulation may be given effect.

“This problem was the subject of conflicting decisions in California until recently, when this

Court, in *Speck v. Wylie*, 1 Cal. (2d) 625 [36 Pac. (2d) 618, 95 A.L.R. 760], announced the governing rule. *It was there held that an innocent principal might by such a stipulation protect himself from liability in a tort action for damages for fraud and deceit, but that the third party would nevertheless be entitled to rescind the contract. This is the rule declared in the Restatement of the Law of Agency, sections 259 and 260.* (See, also, *Lozier v. Janss Investment Co.*, 1 Cal. (2d) 666 [36 Pac. (2d) 620]; *Greenberg v. Du Bain Realty Corp.*, 2 Cal. (2d) 628 [42 Pac. (2d) 628]; *Graham v. Los Angeles First Nat. T. & S. Bank*, 3 Cal. (2d) 37 [43 Pac. (2d) 543].) The distinction between the two situations is a sound one. The principal would normally be liable in tort for misrepresentations by an agent acting within the scope of his actual or ostensible authority, and by stipulating in the contract that the agent has no such authority, the principal has done all that is reasonably possible to give notice thereof to the third party. Under such circumstances the innocent principal may justly be relieved of liability for the agent's wrong. But where the principal sues to recover on the contract, he is seeking to benefit through the agent's fraud. This he cannot be permitted to do. His personal liability may be avoided, but the fraudulently procured contract is subject to rescission.

“In the instant case, the counterclaim, which seeks the affirmative relief of damages, is objectionable for the same reason that an independent tort action would be. * * *” (4 C.2d at 320-21) (Emphasis supplied.)

In *Schroeder v. Dickinson & Gillespie Corp.*, 6 C.A. 2d 175, 44 P.2d 425 (1935), plaintiffs were nonsuited in their action to hold a bank liable for the false representations made by the agents of the bank's predecessor in interest. The misrepresentations were made in connection with the sale of real estate to plaintiffs pursuant to a written contract which contained a provision that the bank was not liable for any inducement, promise, representation or agreement not set forth therein. In affirming the judgment of nonsuit, the Court said,

“The contract in evidence shows that it contained a cautionary clause relieving the principal of liability because of any representations made by any selling agent or other person other than is contained in the contract, and the evidence shows that the representations alleged to be fraudulent were made by agents and codefendants of the seller, the respondent bank, that the bank was innocent of any participation in or knowledge of the alleged false representations, and that the bank executed the contract of sale to appellants. Under the recent decision in the case of *Speck v. Wylie*, 1 Cal. (2d) 625 [36 Pac. (2d) 618, 95 A. L. R. 760], it is held that under such circumstances, no cause of action against the innocent principal may lie for damages for fraud, but that the sole remedy is by timely rescission and an action to recover moneys paid upon the contract. It therefore appears that the motion for a nonsuit was properly granted on the second cause of action under this authority. * * *” (6 C.A.2d at 179)

It is significant that the cases cited and relied upon by appellant at page 17 of his opening brief to overcome the stipulation in the contract against oral representations involve actions of rescission and are thus within the exception of *Speck v. Wylie, supra*. Appellant is not seeking to *rescind* his employment contract but rather to *affirm* it and hold the employer liable for damages for the misrepresentations of the employer's agents. This he can not do because of the stipulation against oral representations.

The other cases cited by appellant in no way meet the issue here presented and each of them is distinguishable on the facts.

II. THE WRITTEN CONTRACT IS INCONSISTENT WITH THE PRIOR ORAL REPRESENTATIONS.

Appellant does not suggest that through some fraud of appellees he was precluded from reading or understanding the employment contract that he admits signing. He is therefore deemed to have intended to enter into the contract in accordance with its precise terms.

Gridley v. Tilson, 202 Cal. 748, 262 Pac. 322 (1927);

Tockstein v. Pacific Kissel Kar Branch, 33 Cal. App. 262, 164 Pac. 906 (1917);

George J. Birkel Co. v. Curtet, 36 Cal. App. 391, 172 Pac. 165 (1918);

cf. *Humphrey v. Harry H. Culver & Co.*, 220 Cal. 765, 32 P.2d 630 (1934).

Since the contract specifically provides for employment at the will of appellees (subject only to the payment of return transportation if the contract is terminated without cause prior to 12 months' service), the contract itself reveals the falsity of the earlier advertisement or solicitation for a one year term of employment.

The contract (R. 16-17) provides in Section 4(a) that appellant "shall work such hours and such shifts as may be required by the Contractor" with appropriate provision in Section 4(b) (2) for compensation for more than 40 hours of work per week. Section 13 of the Contract provides as follows:

"SECTION 13. Military Authority.

The Employee understands that the various sites of the work are under the supervision of military authority. The Employee agrees that any act or omission by the Contractor inconsistent with the provisions hereof shall be excused if such act or omission shall result from the compliance by the Contractor with any order or regulation of such military authority; provided, that the guaranteed weekly employment, as hereinabove stipulated, shall not be suspended."

And Section 15(c) provides in part as follows:

"(c) The Employee shall comply with all laws and regulations, both civil and military, applicable at the site of the work and the vicinity thereof, and such other rules and regulations as the Contracting Officer and the Contractor may

establish from time to time with respect to the personnel employed by the Contractor. * * *”

All of these sections are inconsistent with the alleged oral promises that appellant could engage in private practice. He was plainly on notice that he was subject to perform work for appellees in excess of 40 hours per week; that appellees were required to abide by military regulations; and that he himself had to obey applicable laws and regulations. His amended complaint alleges that “under the rules and regulations of the United States applicable to said Island of Okinawa the said plaintiff could not engage in the private practice of dentistry on said Island.” (Amended Complaint VIII, R. 37) Certainly the contract did not misrepresent applicable rules and regulations and in effect warned him not to rely on prior oral representations as to the regulations applicable on Okinawa.

Where the terms of a written contract are inconsistent with prior misrepresentations, an action for fraud will not lie. Thus, in *W. R. Campbell Co. v. Sears, Roebuck & Co.*, 136 Cal. App. 765, 769-70, 29 P.2d 910 (1934), the Court said,

“* * * In our opinion, however, a distinction must be made between such a parol promise as the one here, which by its very nature is superseded by the final writing, inconsistent with it, and a promise made with no intention of performing the same, not inconsistent with the writing, but which was the inducing cause thereof. We think the former, being evidence of a preliminary agree-

ment entirely superseded by the subsequent writing, is no evidence of the terms of the writing finally agreed upon (Sec. 1856, Code Civ. Proc.), and cannot be relied upon as a fraudulent representation inducing the writing.”

Similarly in *Blake v. Paramount Pictures, Inc.*, 22 F. Supp. 249, 252-53 (S.D. Calif. 1938), the Court stated,

“Here we find *not* an oral representation, omitted from the contract, but a contract in which the parties deal specifically with the matter of the oral representation, and change what might have been an absolute promise into an alternative one, giving one of the parties to the contract the right to substitute another production for one promised. The contract as written is not silent as to the representations or complementary to them. It covers the representations, but specifically provides that, certain contingencies happening, the distributor is not to be bound by them. When this is the case, the other contracting party who complains of misrepresentation must charge fraud in inducing him to sign a contract which did not express the oral promises or representations. See *California Trust Co. v. Cohn*, 1932, 214 Cal. 619, 7 P.2d 297. Or he must allege that the substituted promises were also made without the intention to perform.”

Finally it should be pointed out that appellant was not in a position to rely on the alleged oral misrepresentations in regard to engaging in private practice on Okinawa since he attempted to get a special writ-

ten contract that would so provide and he was refused such a contract. The only reasonable inference from this is that appellant decided to take his chances, knowing full well that he had no binding commitment entitling him to engage in private practice on Okinawa.

CONCLUSION.

For the reasons stated above, the judgment appealed from should be affirmed and the appeal should be dismissed.

Dated, San Francisco, California,
July 19, 1954.

Respectfully submitted,

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No. 14289.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HARRY EDWARD FLORENTINE,

Appellant,

vs.

H. R. LANDON as District Director Immigration and
Naturalization at Los Angeles, and HERBERT BROWN-
ELL as Attorney General of the United States,

Appellee.

BRIEF FOR APPELLEE.

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H. R. LANDON as District Director Immigration and
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ELL as Attorney General of the United States,

Appellee.

BRIEF FOR APPELLEE.

Jurisdiction.

This appeal is taken from a judgment of dismissal which was entered December 2, 1953 by the District Court of the United States, Southern District of California, Central Division, which dismissed petitioner-appellant's petition upon the grounds that there was a failure to state a claim upon which relief could be granted and that there had been a failure to join an indispensable party.

Paragraph III of the petition on file herein [T. R. 4] alleges that the action was brought "under the provisions of Section 903 of the Nationality Act (8 U. S. C. A.), and additionally, under the provisions of the Declaratory Judgment Act, Section 2201 of the New Federal Judicial Code." Whether or not appellant obtained jurisdiction and stated a claim under those statutes is the question to be decided.

This Court has jurisdiction of this appeal pursuant to the provisions of 28 U. S. C. 1291 and 1291(1), there being no dispute that the judgment entered by the District Court is a final judgment [T. R. 13].

Statutes Involved.

Section 503 of the Nationality Act of 1940 (8 U. S. C. 903) reads in part as follows:

“§903. Judicial proceedings for declaration of United States nationality in event of denial of rights and privileges as national; certificate of identity pending judgment.

“If any person who claims a right or privilege as a national of the United States is denied such right or privilege by any Department or agency, or executive official thereof, upon the ground that he is not a national of the United States, such person, regardless of whether he is within the United States or abroad, may institute an action against the head of such Department or agency in the District Court of the United States for the District of Columbia or in the District Court of the United States for the district in which such person claims a permanent residence for a judgment declaring him to be a national of the United States. * * *”

Statement of Case.

On December 9, 1952 petitioner filed his original petition under Section 503 of the Nationality Act of 1940 (8 U. S. C. A., §903). In that petition, H. R. Landon was named as respondent. Landon is the local District Director of Immigration and Naturalization. The petition alleged that Florentine was a citizen and national of the United States and prayed for judgment declaring him to be a citizen.

The above referred to original petition, naming only H. R. Landon, did not conform to the requirements of Section 503 in that it did not name the “head of the Department.” The Department involved in such cases is

the Department of Justice, which is under the direction of and "headed" by the Attorney General of the United States. Therefore, on March 10, 1954 the respondent, Landon, filed a motion to dismiss for lack of jurisdiction over the subject matter, failure to state a claim upon which relief can be granted and failure to join an indispensable party. Before a hearing was had on this motion, however, on April 9, 1953, the petitioner filed an amended petition naming both Landon and Herbert Brownell, Attorney General of the United States, as respondents.

Section 503 of the Nationality Act was repealed on June 27, 1952, c. 477, Title IV, §403(a)(42), 66 Stat. 280, and the statute expired on December 24, 1952. Between the time the original petition naming an incorrect party had been filed and the time the amended petition was filed, the statute authorizing such a proceeding had expired. The Attorney General then moved to dismiss the amended petition under F. R. C. P. 12(b)(1), (2) and (6), 28 U. S. C. A. The parties stipulated that the motion made by Landon to the original petition should be considered as having been made to the amended petition.

Thereafter, on September 8, 1953, the Court filed its written Memorandum of Decision dismissing the action for failure to state a claim upon which relief could be granted and failure to join an indispensable party. *Florentine v. Landon*, 114 F. Supp. 452 (1953). The Court in so ruling found that the amended petition had not made the Attorney General a party as it had been filed after the statute authorizing the action had expired. A judgment of dismissal was entered December 2, 1953.

ARGUMENT.

A. The Original Petition Filed in the Action Failed to Conform to the Statute Authorizing Such Actions.

Petitioner brought his action for a declaratory judgment of citizenship under Section 903 of Title 8, U. S. C. A. This section provides the remedy and prescribes the "judicial proceedings for declaration of United States' nationality in event of denial of rights and privileges as national."

The section states:

"If any person who claims a right or privilege as a national of the United States is denied such right or privilege by any Department or agency, or executive official thereof, upon the ground that he is not a national of the United States, such person, * * * may institute an action against the *head of such Department* * * * in the District Court of the United States * * * for the district in which such person claims a permanent residence for a judgment declaring him to be a national of the United States. * * * " (Emphasis supplied.)

Consequently, the head of the Department is the person against whom the action must be instituted.

H. R. Landon, against whom the original petition was brought, was not the head of the Department of Justice. The proper party respondent should have been the Attorney General of the United States. He is the head of the Department of Justice, in which Department the Immigration and Naturalization Service is but a division. It must be concluded, therefore, that such a suit against H. R. Landon is not authorized by statute and fails to state a claim for which relief can be granted.

Secondly, in such a suit, the Attorney General is an indispensable party, and where an indispensable party is not before the Court, the only possible course for the Court to pursue is to dismiss.

Paper Container Mfg. Co. v. Dixie Cup Co., 74 F. Supp. 389, cert. den. 69 S. Ct. 515, 336 U. S. 909, 93 L. Ed. 1074, rehear. den. 69 S. Ct. 655, 336 U. S. 929, 93 L. Ed. 1089;

Barr v. Rhodes, 35 F. Supp. 223;

American Insurance Co. v. Bradley Mining Co., 57 F. Supp. 545.

The Attorney General is an indispensable party because the statute specifically provides that these actions must be brought against the "head of the Department." The Attorney General, as head of the Department of Justice, is charged with the defense of such actions and should be the party named pursuant to the statute. The plain meaning of the words of the statute cannot be interpreted in any other way.

Congress has waived sovereign immunity from suit by enacting Section 903 of Title 8. In waiving that immunity, it has specified certain conditions which are to be complied with in the event such an action is instituted. One of the conditions is that the head of the Department must be named as the party against whom the action is brought. Since the action may only be instituted against one person, that person is certainly an indispensable party to the action.

B. The Amended Petition Should Not Relate Back to Allow Appellant to Name New Party After Statute Expired.

It is undisputed that the Courts have been very liberal in permitting amendments to pleadings. However, the amended pleading filed in the instant action fails to make the Attorney General a party and fails to state a claim upon which relief can be granted, because it was filed after the statute expired.

The general rule is that an amended pleading will relate back to the date of the original pleading. That general rule is set forth in Rule 15(c) of the Federal Rules of Civil Procedure, which is quoted as follows:

“(c) Relation Back of Amendments. Whenever the claim or defense asserted in the amended pleading arose out of conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading.”

However, the above is the general rule which does not apply under all circumstances and should not apply in the instant case.

As the Court knows, the right to file an action under Section 903 of Title 8 expired on December 24, 1952. It is not unlikely thinking to liken this case to one wherein the statute of limitations is involved, *i. e.*, the right of action in both cases expires on a particular date. Thus, using this analogy, the petitioner's amended complaint naming the new party must be such that the doctrine of relation back will apply, so that the original filing date of the original complaint will bring the petitioner within the jurisdiction of the Court before the expiration date of the statute under which he sues. Without the doctrine

of relation back applying to the petitioner's case, the amendment would be of no avail.

The rule with regard to the doctrine of relation back is stated in *Sechrist v. Palshook*, 97 F. Supp. 505, wherein it is stated:

"Where amendment to record changing name of defendant has the effect of substituting new party for defendant, amendment would amount to new and independent cause of action and cannot be permitted when the statute of limitations has run."

A further statement of the rule is that the amendment of a complaint to change the name of a defendant relates back to the date of the original complaint if the effect of the amendment is merely to correct a misnomer, *but if the effect of the amendment is to bring into a case a new party defendant that was not served with summons or complained against in the original action, amendment does not relate back to time of original complaint and action as to such party is barred by limitations.*

The appellant states in his opening brief on page 4 thereof that he agrees with the statement of the law and the cases cited in the decision of the District Court; namely:

Davis v. L. L. Cohen & Co., 268 U. S. 638, 45 S. Ct. 633, 69 L. Ed. 1129;

Schram v. Poole (9 Cir., 1938), 97 F. 2d 566, 572;

Hammond Knoylton v. United States (2 Cir., 1941), 121 F. 2d 192.

The cases are cited in the opinion below as standing for the rule that a party may not amend after the statute of limitations has run to name a party who was not previously named. The appellant attempts to contrast

these cases, however, by pointing to the fact that they did not involve a Savings Clause.

Deferring the reply to appellant's Saving Clause argument for the moment, we will discuss further the doctrine of relation back. Such a problem arose in the case of *Mellon v. Arkansas Land & Lumber Co.*, 275 U. S. 460, 48 S. Ct. 150, 151, 72 L. Ed. 372. Actions were to be instituted against an agent designated by the President where there were claims against the United States arising out of the Government's control of the railroads during World War I. The agent originally named in the complaint had resigned and there was an attempt to amend the complaint to substitute the name of the proper agent. This amendment, however, was made after the statute of limitations had run. The Court said at 275 U. S. 460, 462:

“* * * The bringing of the suit against Payne, who was not the designated Agent, was not a compliance with this requirement and brought no representative of the Government before the court. *Davidson v. Payne* (C. C. A.), 289 Fed. 69. The substitution of Davis, the designated Agent, was not the correction of an error in the name of the defendant, but the bringing in of a different defendant, and was in effect the commencement of a new and independent proceeding against him to enforce the liability of the Government. See *Davis v. Cohen Co.*, 268 U. S. 638, 642; *Mellon v. Weiss*, 270 U. S. 565, 567. * * *

It has been held that time limits in statutes waiving sovereign immunity operate as a condition of liability besides operating as a period of limitation. In *United States ex rel. Ranch v. Davis* (1925), 56 App. D. C. 46, 8 F. 2d 907, the plaintiff attempted to amend a judgment

after the statute of limitations had run to name the proper agent of the Government as a party. The Court held that to allow the amendment would be to give validity to a judgment subsequent to the time that Congress had waived sovereign immunity and had granted its consent to suit. The Court also states in that decision that this time limitation on suit when imposed by Congress operated as a condition of liability and cites *Finn v. United States*, 123 U. S. 227, 8 S. Ct. 82, 31 L. Ed. 128; and *Davis, Agent v. L. L. Cohen & Co.*, 268 U. S. 638, 45 S. Ct. 633, 69 L. Ed. 1129.

Under either interpretation referred to above, whether the facts of the instant action are considered analogous to a statute of limitations' situation or a condition of liability, the Attorney General was not a party to the action and cannot be made a party following the expiration of the statute.

C. The Savings Clause Would Not Apply to Allow the Amended Complaint to Relate Back.

There was a Savings Clause enacted as part of the Immigration and Nationality Act of 1952. It is known as Section 405 of the Act of June 27, 1952. That section is set forth in pertinent part as follows:

“Savings Clause. Section 405 of Act June 27, 1952, provided in part that:

“(a) Nothing contained in this Act [this chapter], unless otherwise specifically provided therein, shall be construed to affect the validity of any declaration of intention, petition for naturalization, certificate of naturalization, certificate of citizenship, warrant of arrest, order or warrant of arrest, order or warrant of deportation, order of exclusion, or other document or proceeding which shall be valid at the time

this Act [this chapter] shall take effect; or to affect any prosecution, suit, action, or proceedings, civil or criminal, brought, or any status, condition, right in process of acquisition, act, thing liability, obligation, or matter, civil or criminal, done or existing, at the time this Act [this chapter] shall take effect; but as to all such prosecutions, suits, actions, proceedings, statutes, conditions, rights, acts, things, liabilities, obligations, or matters the statutes or parts of statutes repealed by this Act [this chapter] are, unless otherwise specifically provided therein, hereby continued in force and effect * * *

“(b) Except as otherwise specifically provided in title III [subchapter III of this chapter], any petition for naturalization heretofore filed which may be pending at the time this Act [this chapter] shall take effect shall be heard and determined in accordance with the requirements of law in effect when such petition was filed.”

The Savings Clause, however, was not intended to apply to a situation as appears in the instant action. Language in the clause itself discloses that the action, suit or status, “saved” by the clause “shall be valid at the time this act shall take effect.” In subsection (b) of the clause pending actions are referred to and are to be “heard and determined in accordance with requirements of law in effect when such petition was filed.” At the time of filing the petition, however, on December 9, 1952, the statute required the Attorney General as head of the Department to be the responding party. When the petitioner named the District Director of Immigration, he failed to comply with that statute. Therefore, the Sav-

ings Clause would not apply to this case, because there was really no valid pending action.

As was noted in the discussion above, the Attorney General is the one to be named as defendant or respondent. Under the statute, a specific procedure is set up for petitions of the nature of that filed in the instant case. When the petitioner failed to comply with the statute, no officer or agent of the Government was before the Court and the petition was in legal effect, a nullity. There was actually nothing to save unless an amendment joined the Attorney General before the statute expired, which was not done.

If the Savings Clause were carried to the extreme which is urged by the appellant herein, it would seem that anyone born prior to December 24, 1952, could petition for a declaration of nationality under the Nationality Act of 1940. This interpretation, however, would be incorrect, for we know that actions filed after December 24, 1952, have to be filed and determined according to the Nationality Act of 1952. Congress did not intend that anyone in any circumstances came under the provisions of the old act. Only those which had rights accrued or had obtained some status within the framework of the old law would be entitled to use the provisions of that law.

Numerous decisions state that by enacting a savings clause in a statute, Congress intends that statute to operate prospectively only. There is to be no retroactive effect given to the new statute. The facts of the case at bar, however, fit in to a situation where the Nationality

Act of 1952 is given only prospective application. No cause of action had been stated under the old act as has been discussed above prior to the time it expired. From the date of the expiration of the 1940 Act until the present, the 1952 act has applied. Therefore, when there was an attempt by the plaintiff to state a new cause of action under the old act by adding a new party after its expiration date, it was an attempt to extend the life of the old act beyond the time Congress had intended.

Conclusion.

Appellant has raised the point that the Attorney General had never appeared in the action and his motion to dismiss was not properly before the Court. However, the Notice of Motion, Motion and Points and Authorities submitted in support of the motion filed July 8, 1953 are submitted and filed by Herbert Brownell, appearing specially.

The petition, as originally filed in December of 1952, failed to name an indispensable party and failed to state a claim upon which relief could be granted. This occurred because there had been a clear failure to comply with the statute authorizing suits against an agent of the Government. Appellant's complaint was thereafter amended after the Nationality Act of 1940 had expired. The amended complaint should not relate back to the date of filing the original complaint under these circumstances, and, therefore, the amendment was not effective. An indispensable party was not before the Court when

the statute expired and there was a failure to state a claim upon which relief could be granted.

The Savings Clause enacted with the Nationality Act of 1952 will not aid the appellant in this case. Since the amended complaint could not relate back, there was no proper action or status of the petitioner to save. Congress has power to change the *remedy* and the Savings Clause in the 1952 Act did not preserve the *remedy* of the 1940 Act. *Alvina v. Brownell*, 112 F. Supp. 15 (1953).

Appellee prays that the decision of the District Court be affirmed.

Respectfully submitted,

LAUGHLIN E. WATERS,
United States Attorney,

MAX F. DEUTZ,
Assistant U. S. Attorney,
Chief of Civil Division,

ANDREW J. DAVIS,
Assistant U. S. Attorney,
Attorneys for Appellee.

No. 14334

United States
Court of Appeals
for the Ninth Circuit

CHARLES B. SMITH, as Special Administrator
of the Estate of Edward S. Birn, Deceased,
Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER,
JACK L. WARNER, UNITED STATES
PICTURES, INC., and WARNER BROS.
PICTURES, INC., Appellees.

Transcript of Record

In Two Volumes

VOLUME I.

(Pages 1 to 292, inclusive)

Appeal from the United States District Court for the Southern
District of California, Central Division

FILED

NOV 30 1954

PAUL P. O'BRIEN,
CLERK

No. 14334

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CHARLES B. SMITH, as Special Administrator
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Los Angeles 14, California.

For Appellees Milton Sperling, et al.:

OLIVER B. SCHWAB,

149 El Camino Drive,
Beverly Hills, California. [1*]

* Page numbers appearing at foot of page of original Transcript of Record.

In the United States District Court for the Southern District of California, Central Division

No. 9005-WM

EDWARD S. BIRN,

Plaintiff,

vs.

MILTON SPERLING, HARRY M. WARNER,
JACK L. WARNER, UNITED STATES
PICTURES, INC., and WARNER BROS.
PICTURES, INC., Defendants.

COMPLAINT

Accounting and Damages

Plaintiff herein suing derivatively on behalf of and for the benefit of defendant Warner Bros. Pictures, Inc., and the stockholders thereof, complains as follows: (All of the allegations below being upon information and belief except allegations "1" to "4" inclusive and allegation "20", which are alleged as of plaintiff's knowledge.)

For a First Cause of Action Against All The Defendants

1. Jurisdiction herein is founded on diversity of citizenship and amount. This action is not a collusive one to confer on this court jurisdiction of an action over which it would not otherwise have jurisdiction.

2. The matter in controversy exceeds, exclusive of interest and costs, the sum of \$3000.

3. Plaintiff is a citizen of the State of New York. [2]

4. Plaintiff is, and has been, during the time that the transactions herein complained of occurred, the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc., having owned said stock since August 21st, 1944.

5. Defendants Warner Bros. Pictures, Inc., (hereinafter referred to as Warner Bros.) and United States Pictures, Inc. (hereinafter referred to as United) are corporations incorporated under the laws of the State of Delaware, engaged in the motion picture business and said corporations do business and maintain offices in the County of Los Angeles and State of California.

6. The defendants Milton Sperling, Harry M. Warner, and Jack L. Warner are citizens of the State of California.

7. That during the time that the transactions hereinbelow complained of occurred, the defendants, Harry M. Warner, Jack L. Warner, were directors of Warner Bros.

8. That the Board of Directors of defendant Warner Bros., presently consists of defendants Harry M. Warner, Jack L. Warner, Morris Wolf and of John E. Bierwirth, Robert W. Perkins, Samuel Carlisle, Waddill Catchings, Stanleigh P. Friedman, Charles S. Guggenheimer, Samuel Schneider and Albert Warner.

9. That the aforementioned Harry M. Warner, Jack L. Warner and Albert Warner are brothers and the aforesaid Milton Sperling is the son-in-law of Harry M. Warner.

10. That at all times herein mentioned the de-

fendants Harry M. Warner and Jack L. Warner, together with their brother, Albert Warner owned a large and controlling block of the outstanding capital stock of Warner Bros. and said three brothers did control and dominate Warner Bros. and did actively direct its supervision, policies, actions and business including the acts hereinafter alleged in this complaint and did actually select, dominate and control the directors and officers of Warner Bros.

11. That in or about or prior to the summer of 1945 the [3] individual defendants did, as is hereinbelow more fully alleged, illegally, wrongfully and in bad faith, conspire and act together to waste, mismanage, divert and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling and United at the expense of Warner Bros., and the different things and acts done by said individual defendants, and by the corporate defendants through their directors and officers, as hereinbelow alleged, were all steps in said conspiracy and were committed pursuant thereto.

12. That on or about August 6th, 1945, defendant United was caused to be organized by defendant Sperling with nominal capital contributions and the capital stock of said corporation was issued to Sperling and one other. That since September, 1946, defendant Sperling has been the sole stockholder of defendant United.

13. That said corporation was organized in order

that through it, the defendant Sperling might wrongfully utilize and divert from Warner Bros. the funds, credits, facilities, assets and business opportunities of Warner for his private purposes and benefits.

14. Thereafter and in or about September, 1945, the defendants caused Warner Bros. and United to enter into an agreement which provided in substance as follows:

Six motion pictures were to be produced by United at the studio, and with the facilities and personnel of, Warner Brothers. Said pictures were to be distributed by Warner Bros. through its subsidiaries, the latter to retain out of the gross proceeds of distribution certain percentages and sums as fees and expenses of distribution and the net profits from the production and distribution of said pictures were to be shared equally between Warner Bros. and United.

Warner Bros. was to advance 50% of the cost of production of said pictures and the remaining 50% of said cost was to be advanced by United. In this latter connection, however, United was authorized to borrow its entire share of the cost of production and [4] was further authorized to pledge as security for such borrowing, the pictures to be produced, including the negatives and positive prints thereof and including the entire net proceeds of the distribution of said pictures, and Warner Bros. was to agree to such pledge and thereby subordinate its investment and provide with its funds the collateral security for the loan to United.

15. That at the time of the making of said agreement, it was intended by defendants that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of said six motion pictures by means of the borrowing privileges set forth in said agreement.

16. That in furtherance of said agreement and intention as set forth in the two preceding paragraphs and in or about November 1945, the defendants caused an agreement to be entered into between Warner Bros. and United and The New York Trust Company (the latter being a New York banking corporation) for the loan by The New York Trust Company to United, of the latter's share of the cost of production of the pictures as aforesaid and under said agreement there was pledged as security for the repayment of said loans the security described in allegation "14" hereinabove; and said loan agreement further provided that after said loans had been repaid and after the share of the production costs of the pictures advanced by Warner Bros. had likewise been repaid, the net profits resulting from the pictures were to be shared equally between Warner Bros. and United.

17. That said loan agreement was effectuated through the use of the valuable credit and banking facilities and connections of Warner Bros. in that John E. Bierwirth, a director of Warner Bros., is and has been president of The New York Trust Company since 1941, and his influence was used to

effect said loan agreement, and further, in that Warner Bros. is a valued customer of The New York Trust Company and its patronage is favorably sought for various [5] reasons including the fact that Warner Bros. was then indebted to a syndicate of banks, including The New York Trust Company, to the extent of several million dollars.

18. That in pursuance of said agreements as alleged in paragraphs numbered "14" and "16" above and during the period commencing in or about November 1945 to date, United has borrowed large sums from The New York Trust Company and the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being used by United, and the said agreements have been in part performed and motion pictures are being produced and distributed under said agreements and said agreements remain in part unperformed.

19. That in connection with the performance of said agreements United has not advanced any of its private funds or capital and has contributed to the costs of production of said pictures solely out of the loans from The New York Trust Company aforementioned.

20. That plaintiff did not discover the facts set forth in allegations "11" to "19" inclusive herein until October of 1948 and plaintiff had no notice or information of circumstances which would put him on inquiry regarding such facts until October of 1948.

21. That by reason of the premises, Warner Bros. has suffered and still suffers improper and illegal

waste, mismanagement, misappropriation and diversion of its valuable assets, credits, facilities and business opportunities all to its loss and to the improper and personal profit and benefit of United, and Sperling in that;

(a) The aforesaid agreements and the amount of return or profit provided thereunder to Warner Bros. and the amount of distribution fees provided thereunder to its subsidiaries are grossly unreasonable and unfair to Warner Bros. and its subsidiaries and are not in accordance with customary agreements in the motion picture industry; and (b) Warner Bros., in effect, has been and still is providing the use of its funds, credits, facilities and assets to [6] defendant United without any adequate, reasonable or legal consideration, return, or payment to Warner Bros.; and

(c) Warner Bros. in effect, has been and still is undertaking the sole risk of capital and bearing the entire burden of the cost of production of said motion pictures involved in the aforesaid agreement, and in the event of loss in said productions, Warner Bros. will suffer the entire or principal amount thereof inasmuch as United has advanced no capital and is financially unable to meet or share any substantial losses; and despite the foregoing Warner Bros. receives only 50% of the net profits and the other 50% of the said profits goes to United, such profit divisions being grossly unfair to Warner Bros. and the receipt by United of said profits and benefits under said agreements constitutes an im-

proper and unconscionable gift or advantage to United at the expense of Warner Bros.; and

(d) The subordination and use of the capital assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes an improper or illegal use of property of Warner Bros. for which the latter receives in return no legal or adequate consideration; and

(e) The subordination and use of the capital, assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes a breach of the existing written agreement between Warner Bros. and a syndicate of banks under which Warner Bros. is the recipient of large business loans totalling several millions of dollars, and the said last named written agreement with said banks prohibits such use of the capital and assets of Warner Bros., and thereby Warner Bros. is endangering said loans and injuring its credit. [7]

22. That all of the acts and matters alleged in this complaint were then known or with the exercise of reasonable diligence should have been then known to the defendants, and all of the defendants either actively participated in said acts or matters or with knowledge of the same and the course of conduct being pursued, ratified said acts or matters or failed to take any corrective measures.

23. That by reason of the premises, the defendant United and its assets, and the profits and benefits derived by it under the above mentioned agree-

ments, are substantially based upon, result from, and stand in the place of, the assets and business opportunities wrongfully diverted from Warner Bros. to United and hence the capital stock of United and all of its said assets belong in equity and good conscience to Warner Bros.

24. Demand upon the directors of Warner Bros. to institute this action would be futile and plaintiff has made no such demand because all or a majority of the present board of directors and officers of said corporation wrongfully participated in the acts and grievances herein complained of and said board of directors is controlled by the active wrongdoers herein, and since those to whom application would have to be made to institute this suit are the same persons who wrongfully caused or permitted the grievances herein complained of, such persons would refuse to bring suit against themselves and in fact would be disqualified from faithfully doing so.

25. Plaintiff has no adequate remedy at law and he and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted.

For a Second Cause of Action Against All Defendants Except United and Sperling.

26. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "25" (except "11") inclusive with the same force and effect as though herein alleged. [8]

27. That by reason of the acts committed by these defendants as herein alleged, the individual defend-

ants, while acting in their fiduciary capacities and while charged with their fiduciary duties as directors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, nonfeasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

For a Third Cause of Action Against All Defendants Except United and Sperling.

28. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "10" inclusive and "24" and "25" with the same force and effect as though herein alleged.

29. That heretofore and prior to December 8, 1942, defendants caused Warner Bros., in conspiracy and concert with other large motion picture producing and distributing companies, to illegally and wrongfully combine and monopolize the distribution by Warner Bros. and certain of its subsidiaries, of motion picture in the city of Philadelphia, state of Pennsylvania, in restraint of trade and in violation of the laws of the United States, known as the Sherman Anti-Trust Act (15 U.S.C.A.1) and the Clayton Act (15 U.S.C.A. 15).

30. That thereupon on December 8, 1952, William Goldman Theatres, Inc., a corporation engaged in business as a motion picture distributor and exhibitor in Philadelphia, claiming to be aggrieved by said monopoly, brought suit in the United States

District Court for the Eastern District of Pennsylvania against Warner Bros. and its said subsidiaries and said other motion picture companies, which suit was entitled William Goldman Theatres, Inc., vs. Loews, Inc., and in which suit the plaintiff therein sought to enjoin said monopolistic practices and to recover from the defendants therein triple the damages suffered by said plaintiff as the result of said practices. [9]

31. That said suit terminated on December 8, 1946, in a judgment for the plaintiff therein which judgment decreed that the defendants in that suit were all guilty of illegal monopoly in violation of the Sherman Anti-Trust Act and which judgment enjoined said defendants from monopolistic practices and awarded to the plaintiff therein treble damages amounting to \$375,000, plus \$60,000 for said plaintiff's counsel fees. Said judgment was affirmed by the United States Circuit Court of Appeals on January 6th, 1948, and certiorari was denied by the United States Supreme Court on May 3, 1948. That said total award of \$435,000 was thereafter paid by said defendants to said plaintiff on or about May 23, 1948.

32. That subsequently said plaintiff's counsel obtained from said United States District Court an additional allowance against said defendants of \$15,000 for additional legal services in said lawsuit, which additional counsel fee allowance was paid by said defendants.

33. That of the said total amount of \$450,000 paid to William Goldman Theatres, Inc., and its

counsel, by the defendants in the said lawsuit, Warner Bros. and its subsidiaries contributed a large, if not a major aliquot share amounting to several thousands of dollars.

34. In connection with said lawsuit, Warner Bros. and its subsidiaries also suffered and paid out many thousands of dollars in counsel fees and expenses incurred by them in the defense of said action.

35. That the acts of Warner Bros. and its subsidiaries through their officers, agents and employees, upon which the aforesaid judgment was based, were in violation of the aforesaid laws of the United States and were against public policy.

36. That said acts of Warner Bros. and its subsidiaries were caused to be committed by the individual defendants herein as directors of Warner Bros. although said defendants then knew or [10] with the exercise of reasonable diligence should have then known that said acts were in violation of said law.

37. That the individual defendants willfully or negligently actively participated in causing Warner Bros. and its subsidiaries to perform the aforesaid acts or else with knowledge of the course of conduct being pursued ratified said acts and failed to take corrective measures.

38. That if not for the negligence or willful acts of defendants as aforesaid Warner Bros. would not have engaged in said illegal acts and would not have been subject to the aforesaid lawsuit and

would not have been obliged to pay out the large sums of money as aforesaid.

39. That by reason of the acts committed by these defendants as herein alleged, the individual defendants, while acting in their fiduciary capacities and while charged with their fiduciary duties as directors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, non-feasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

Wherefore plaintiff demands judgment as follows:

(1) That the defendants account to Warner Bros. for all losses and damages suffered by it and its subsidiaries and for all profits and benefits received by said defendants, and that defendants make restitution accordingly.

(2) That a trust be impressed upon the capital stock and assets of United in favor of Warner Bros.

(3) That the agreement between Warner Bros. and United to the extent that the same is unexecuted and to the extent that it is practicable to do so, should be cancelled and terminated.

(4) That plaintiff be allowed the costs, disbursements and expenses of this action, including reasonable counsel and accountants' [11] fees.

(5) That such other and further relief be granted as shall be equitable in the premises.

SIDNEY A. MOSS,
GEORGE C. LYON,

/s/ By SIDNEY A. MOSS,
Attorneys for Plaintiff. [12]

Duly Verified. [13]

[Endorsed]: Filed December 15, 1948.

[Title of District Court and Cause.]

ANSWER BY DEFENDANTS SPERLING AND
UNITED STATES PICTURES, INC.

Defendant Milton Sperling and defendant United States Pictures, Inc., in answer to the complaint herein for themselves only, state:

First Cause of Action.

1. Said defendants deny each and every allegation contained in Paragraphs 2, 11, 13, 15, 19, 21, 21(a), 21(b), 21(c), 21(d), 21(e), 22, 23 and 25 of the complaint.

2. Said defendants are without knowledge or information sufficient to form a belief as to the truth of any of the allegations contained in Paragraphs 3, 4, 8, 10, 20 and 24 of the complaint.

3. Said defendants deny the allegations contained in Paragraph 12 of the complaint, except that they admit that United States Pictures, Inc. was organized on or about August 6, 1945.

4. Said defendants deny the allegations contained

in Paragraph 14 of the complaint except that they admit that on or about September 28, [14] 1945, the defendant Warner Bros. Pictures, Inc. and defendant United States Pictures, Inc. entered into a written agreement concerning the production by United States Pictures, Inc. of motion pictures, to which agreement the Court is respectfully referred for the true terms, provisions and conditions thereof.

5. Said defendants deny the allegations contained in Paragraph 16 of the complaint except that they admit that in or about November, 1945, a written agreement was entered into between defendant Warner Bros. Pictures, Inc., defendant United States Pictures, Inc. and The New York Trust Company concerning loans by the latter to United States Pictures, Inc. for use in producing motion pictures, to which agreement the Court is respectfully referred for the true terms, provisions and conditions thereof.

6. Said defendants deny the allegations contained in Paragraph 17 of the complaint except that they admit that John E. Bierwirth has been president of The New York Trust Company for some period of time.

7. Said defendants deny the allegations contained in Paragraph 18 of the complaint except that they admit that defendant United States Pictures, Inc. has borrowed sums of money from The New York Trust Company and that the agreements referred to in the foregoing paragraphs 5 and 4 of this Answer have been in part performed, that mo-

tion pictures are being produced and distributed under said agreements and said agreements remain in part unperformed.

Second Cause of Action

8. Said defendants repeat and reallege each and every allegation contained in Paragraphs 1 to 7 above by way of answer to Paragraph 26 of the complaint.

9. Upon information and belief, said defendants deny the allegations contained in Paragraph 27 of the complaint.

Affirmative Defense to First and Second Causes of Action.

10. Each said cause of action did not accrue within three years before the commencement of this action and that said action is barred. [15]

Second Affirmative Defense to First and Second Causes of Action.

11. Each said cause of action did not accrue within three years before the commencement of this action and that said action is barred by the New York Statute of Limitations.

Third Affirmative Defense to First and Second Causes of Action

12. The causes of action set forth in the complaint did not accrue within two years before the commencement of this action and that said action is barred by the California Statute of Limitations.

Fourth Affirmative Defense to First and Second
Causes of Action.

13. Each said cause of action did not accrue within three years before the commencement of this action and that said action is barred by the California Statute of Limitations.

Fifth Affirmative Defense to First and Second
Causes of Action.

14. Each said cause of action did not occur within three years before the commencement of this action and that said action is barred by the Delaware Statute of Limitations.

Sixth Affirmative Defense to First and Second
Causes of Action.

15. The complaint fails to set forth with particularity the efforts of the plaintiff to secure from the managing directors or stockholders of the defendant Warner Bros. Pictures, Inc. such action as plaintiff desires and the reasons for his failure to obtain such action or the reasons for not making such effort. Such reasons as plaintiff does allege in Paragraph 24 of the complaint are insufficient to excuse efforts by the plaintiff to secure from the directors and shareholders of Warner Bros. Pictures, Inc. such action as plaintiff desires. [16]

Seventh Affirmative Defense to First and Second
Causes of Action.

16. Both the First and Second Cause of Action of the complaint fail to state a claim against defendant United States Pictures, Inc. or defendant Milton Sperling, upon which relief can be granted.

Wherefore defendant United States Pictures, Inc. and defendant Milton Sperling demand that the First and Second Causes of Action of the complaint herein be dismissed and that they have their costs and disbursements in this action.

OLIVER B. SCHWAB and
ARTHUR LIVINGSTON,

/s/ By OLIVER B. SCHWAB,
Attorneys for Defendants United States Pictures,
Inc. and Milton Sperling. [17]

[Endorsed]: Filed April 1, 1949.

[Title of District Court and Cause.]

ANSWER OF DEFENDANTS HARRY M.
WARNER, JACK L. WARNER, AND WAR-
NER BROS. PICTURES, INC.

Come now the defendants, Harry M. Warner, Jack L. Warner, and Warner Bros. Pictures, Inc., and answer the complaint herein as follows:

As to the Alleged First Cause of Action

1. Upon information and belief, deny each and every allegation contained in paragraphs 2, 12, 15, 19 and 25 of the complaint.

2. Deny having any knowledge or information sufficient to form a belief concerning the truth of any allegations contained in paragraphs 3, 4, and 20 of the complaint.

3. Deny each and every allegation in paragraph 10 of the complaint except that they admit that at

all the times mentioned in the complaint, Harry M. Warner and Jack L. Warner, together with their brother, Albert Warner, owned shares of the outstanding capital stock of Warner Bros. Pictures, Inc.

4. Deny each and every allegation contained in paragraphs [18] 11, 13, 21, 21(a), (b), (c), (d), (e), 22 and 23 of the complaint.

5. Upon information and belief deny each and every allegation contained in paragraph 14 of the complaint except that they admit that in or about September 1945, Warner Bros. Pictures, Inc. entered into an agreement with United States Pictures, Inc., to which agreement the Court is respectively referred for the true terms, provisions and conditions thereof.

6. Upon information and belief deny each and every allegation contained in paragraph 16 of the complaint, except that they admit that in or about November 1945, an agreement was entered into between Warner Bros. Pictures, Inc., United States Pictures, Inc., and The New York Trust Company, and respectfully refer the Court to said agreement for the true terms and conditions thereof.

7. Upon information and belief deny each and every allegation contained in paragraph 17 of the complaint, except that they admit that John E. Bierwirth, a Director of Warner Bros. Pictures, Inc., is and has been for several years President of the New York Trust Company, but deny having any knowledge or information concerning the exact period of his incumbency.

As and for a Complete Defense to the Alleged First and Second Causes of Action, the Defendants Allege:

17. That each said cause of action stated in the complaint did not accrue within three years before the commencement of the action, and that said action is barred by the California Statute of Limitations.

As and for a Complete Defense to the Alleged Third Cause of Action, the Defendants Allege:

18. That the cause of action stated in the complaint did not accrue within three years before the commencement of the action and that said action is barred by the California Statute of Limitations.

As a Second Complete Defense to the Alleged Third Cause of Action, the Defendants Allege:

19. That the cause of action stated in the complaint did not accrue within six years before the commencement of the action and that said action is barred by the applicable Statute of Limitations of the State of Pennsylvania.

As and for a First Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

20. That each of said causes of action stated in the complaint did not accrue within three years before the commencement of the action and said action

is barred by the applicable Statute of Limitations of the State of New York. [21]

As and for a Second Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

21. That each said cause of action stated in the complaint did not accrue within three years before the commencement of the action, and that said action is barred by the applicable Statute of Limitations of the State of Delaware.

As and for a Third Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

22. That the complaint fails to comply with rule 23(b) of the Federal Rules of Civil Procedure and particularly the provision thereof which requires the complaint to set forth with particularity the efforts of the plaintiff to secure from the managing directors of the corporation and from the stockholders thereof such action as he desires and the reasons for his failure to obtain such action or the reason for not making such effort.

As and for a Fourth Complete Defense to All Alleged Causes of Action These Answering Defendants Allege:

23. That the complaint fails to state a claim against the defendants, upon which relief can be granted.

Wherefore, the defendants demand judgment that the complaint herein be dismissed with costs and disbursements of this action.

FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for Harry M. Warner, Jack L. Warner,
Warner Bros. Pictures, Inc. [22]

Acknowledgment of Service attached. [23]

[Endorsed]: Filed April 4, 1949.

[Title of District Court and Cause.]

STIPULATION OF FACTS

The following Stipulation of Facts is entered into by and between all of the parties to the above entitled action, by and through their respective counsel, for the purposes of this action only, and upon the understanding that each party reserves the right to object to the relevancy, materiality, or competency of any of said facts, and upon the further understanding that said facts so stipulated are not all of the facts expected to be offered in evidence, and each party reserves the right to offer any part or parts of this Stipulation, and also such evidence as it desires in addition to the hereinafter stipulated facts and for the purpose of establishing or disproving any and all other facts in issue which are not stipulated: [24]

1. Plaintiff Edward S. Birn is now and at all times relevant to this proceeding has been a resi-

dent of the State of New York and is now and has been, since August 21, 1944, the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc., a Delaware Corporation hereinafter referred to as "Warner Bros."

2. The following persons were directors of Warner Bros. during the period stated after their respective names: Harry M. Warner, 1923 to date; Jack L. Warner, 1923 to date; Albert Warner, 1923 to date; Waddill Catchings, 1925 to date; Morris Wolf, 1929 to date; Stanleigh P. Friedman, 1931 to date; Charles S. Guggenheimer, 1932 to date; Samuel Carlisle, 1934 to date; Robert W. Perkins, 1936 to date; Samuel Schneider, 1944 to date; Joseph Bernhard, 1936 to Sept. 10, 1945; John E. Bierwirth, Nov. 23, 1945, to date. During the period January 1, 1945, to September 10, 1945, the Board of Directors of Warner Bros. consisted of all the above named persons, except John E. Bierwirth; from September 10, 1945, to November 23, 1945, neither Joseph Bernhard nor John E. Bierwirth was a member of said Board. On and after November 23, 1945, to date, the Board of Directors of Warner Bros. consisted of all of the above named persons, except Joseph Bernhard.

3. During the year 1945 Harry M. Warner held 150,000 shares, Jack L. Warner held 208,800 shares, and their brother Albert Warner held 210,000 shares of the common capital stock of Warner Bros. There were outstanding during that time after deducting shares held in the Treasury about 3,701,-

090 shares of common stock. [25] During that time Harry M. Warner, Jack L. Warner, and Albert Warner owned approximately 15% of the issued and outstanding common stock, and thereafter continued to own approximately this percentage during all times relevant to these proceedings.

4. On August 4, 1945, United States Pictures, Inc., hereinafter called "United", was organized as a Delaware Corporation. On September 4, 1945, defendant Milton Sperling paid into United the sum of \$12,500 and received 125 shares of its capital stock which were issued to him on September 6, 1945. On September 4, 1945, Joseph Bernhard paid into United the sum of \$12,500 and received 125 shares of its capital stock which were issued to him on September 6, 1945. From September 6, 1945, to September 18, 1946, Milton Sperling and Joseph Bernhard each held 125 shares of capital stock of United and were, during such period of time, the holders of all of the issued and outstanding shares of United. On September 18, 1946, Milton Sperling acquired the 125 shares theretofore standing in the name of Joseph Bernhard. On December 23, 1946, said certificate for 125 shares was cancelled and a certificate for 63 of said shares was issued to Milton Sperling, which shares he has held since then (in addition to the 125 shares originally held by him), and 62 shares were issued to Title Insurance & Trust Co., Los Angeles, as trustee. The ownership of the issued and outstanding shares in United has remained the same from that date to the present time.

5. Warner Bros. and United entered into the following written agreements:

(a) Basic Agreement dated September 28, 1945;
(b) Amendment to Basic Agreement dated November 2, 1945;

(c) Amendment to Basic Agreement dated May 20, 1946;

(d) Supplement and Amendment to Basic Agreement dated December 6, 1947;

(e) Amendment to Basic and Supplemental Agreement dated [26] December 9, 1947;

(f) Amendment to Basic and Supplemental Agreement dated February 3, 1948;

(g) Amendment to Basic and Supplemental Agreement dated July 21, 1950.

There will be submitted to the Court photostat copies of each of these agreements which may be received by the Court with the same force and effect as if they were the original signed copies of these agreements. The officers signing each of the above documents were duly elected and qualified officers of the corporation on behalf of which each signed.

6. United, Warner Bros., and the New York Trust Co., a New York banking corporation, entered into the following written agreements in which each of the three was a party thereto:

Agreement dated October 31, 1945:

Agreement dated July 20, 1946, amending in part the agreement of October 31, 1945:

Amendment dated February 25, 1948, to agreement dated October 31, 1945.

Photostat copies of these agreements will be pre-

sented to the Court and may be received by the Court with the same force and effect as if they were original signed copies of these agreements. The officers signing each of the above documents were duly elected and qualified officers of the corporation on behalf of which each signed.

7. The following agreements between United and Warner Bros. were approved by the Board of Directors of Warner Bros.:

The Basic Agreement dated September 28, 1945;

The Amendment thereto dated November 2, 1945;

The Amendment to the Basic Agreement dated May 20, 1946;

The Amendment to the Basic Agreement dated December 6, 1947;

The Amendment to the Basic Agreement dated July 21, 1950. [27]

There will be submitted to the Court copies of portions of Minutes of the Board of Directors' meetings of Warner Bros. held September 25, 1945, September 28, 1945, November 23, 1945, June 18, 1946, and August 17, 1950, which may be received by the Court with the same force and effect as if they were originals. Other than above referred to there are no minutes of directors' meetings of defendant Warner Bros. Pictures, Inc., for the period January 1, 1945, to date, pertaining to agreements, relations and understandings between Warner Bros. Pictures, Inc., and United States Pictures, Inc.

8. That on or about January 10, 1946, and prior to the annual stockholders' meeting of Warner

Bros., held on February 19, 1946, there was mailed to each and every stockholder of record of Warner Bros. a notice of said meeting accompanied by a proxy statement, a form of proxy, and an annual report of said company dated August 31, 1945: That copies of said documents have been submitted to counsel for all parties, and copies thereof may be introduced without further identification or foundation.

There are no minutes of stockholders' meetings of defendant Warner Bros. for the period January 1, 1945, to February 27, 1950, pertaining to agreements, relations, and understandings between Warner Bros. Pictures, Inc., and United States Pictures, Inc.

9. There will be submitted to the Court copies of portions of Minutes of the Board of Directors' meetings of United held August 31, 1945, October 4, 1945, November 2, 1945, July 9, 1946, and stockholders' meetings held July 9, 1946, July 23, 1947, July 13, 1948, July 12, 1949, and July 11, 1950, which may be received by the Court with the same force and effect as if they were originals. Other than the above referred to, there are no minutes of Directors' meetings of defendant United for the period January 1, 1945, to date, pertaining to agreements, relations and understandings between Warner Bros. and United and no minutes [28] of stockholders' meetings of defendant United for the period January 1, 1945, to date, pertaining to agreements, relations and understandings between Warner Bros. and United.

10. On July 1, 1943, Warner Bros. entered into a loan agreement with the First National Bank of Boston, the New York Trust Co., Guarantee Trust Company of New York, Continental Illinois National Bank & Trust Company of Chicago, Pennsylvania Company for Insurance on Lives and Granting Annuities, the Union Trust Company of Pittsburgh, covering a loan of fifteen million dollars maturing in various amounts on various dates ending June 1, 1949. This loan was paid off in full by June 28, 1945. A photostat copy of this loan agreement will be presented to the Court, which may be received by the Court with the same force and effect as if it were an original, duly executed copy of said loan agreement.

As of June 28, 1945, Warner Bros. entered into another loan agreement, which loan agreement was incorporated in nine promissory notes of Warner Bros., all dated June 28, 1945, payable respectively to the following banks in the following amounts:

Banks	Amount
New York Trust Company.....	\$ 2,297,297.00
Guaranty Trust Co.	3,445,946.00
First National Bank—Boston	2,756,757.00
Continental Illinois Nat. Bank.....	2,756,757.00
Union Trust Company Pittsburgh	2,756,757.00
The Pennsylvania Co., etc.	1,148,649.00
Bankers Trust Company—N. Y.....	918,919.00
National City Bank—Cleveland.....	459,459.00
First National Bank—Minneapolis.....	459,459.00
	<hr/>
	\$17,000,000.00

All of said notes were in the same form except for the name of the payee banks and the amount of

the notes. There will be submitted to the Court, a photostat copy of one of the notes, to wit, the note payable to New York Trust Co., dated June 28, 1945, in the sum of \$2,297,297.00 and such photostat may be received with the same force and effect as the original executed note. These notes were all paid off on August 29, 1945. [29]

On August 29, 1945, Warner Bros. entered into a further loan agreement, such loan agreement being incorporated in the promissory notes, for a new series of notes totaling \$37,000,000.00, which were issued and delivered to the following banks in the following amounts:

Banks	Amount
New York Trust Co.—N. Y.....	\$ 5,000,000.00
Guaranty Trust Co.—N. Y.....	7,500,000.00
First National Bank—Boston	6,000,000.00
Continental Ill. Nat. Bank—.....Chicago....	6,000,000.00
Union Trust Co.—Pittsburgh	6,000,000.00
The Pennsylvania Co., etc.	2,500,000.00
Bankers Trust Company—N. Y.....	2,000,000.00
National City Bank—Cleveland.....	1,000,000.00
First National Bank—Minneapolis	1,000,000.00
	<hr/>
	\$37,000,000.00

All of said notes were in the same form except the name of the payee banks and the amount of the notes. There will be submitted to the Court a photostat copy of the first of these notes, to wit, the one to New York Trust Co., in the sum of five million dollars, and said photostat may be received by the Court with the same force and effect as the original executed note. These notes were paid in full by December 10, 1945.

On December 10, 1945, a new series of notes, totaling \$30,229,000.00, were issued and delivered by Warner Bros. to the following banks in the following amounts:

Banks	Amounts
New York Trust Co.—N. Y.....	\$ 4,085,000.00
Guaranty Trust Co.—N. Y.....	6,127,500.00
First National Bank—Boston	4,902,000.00
Continental Ill. Nat. Bank—Chicago.....	4,902,000.00
Union Trust Co.—Pittsburgh	4,902,000.00
The Pennsylvania Co., etc.	2,042,500.00
Bankers Trust Co.—N. Y.....	1,634,000.00
National City Bank—Cleveland	817,000.00
First National Bank—Minneapolis.....	817,000.00
	<hr/>
	\$30,229,000.00

All of the said notes were in the same form except the name of the payee banks and the amount of the notes. There may be received in evidence a photostat copy of the first of these [30] notes, to wit, the one to New York Trust Co., New York, in the sum of \$4,085,000.00. Such photostat shall have the same force and effect as the original note. All of said notes were paid off in full by May 29, 1946.

On May 29, 1946, Warner Bros. made a new note issue aggregating \$23,865,000.00, due serially to May 1, 1954, with the other terms and conditions thereof incorporated therein, to the following banks in the following amounts:

Banks	Amount
New York Trust Company—N. Y.....	\$ 3,225,000.00
Guaranty Trust Company—N. Y.....	4,837,500.00
First National Bank—Boston	3,870,000.00
Continental National Bank—Chicago	3,870,000.00
Union Trust Company—Pittsburgh (Now Mellon National Bank & Trust Co.).....	3,870,000.00

Pennsylvania Co., etc.	1,612,500.00
Bankers Trust Company	1,290,000.00
National City Bank—Cleveland	645,000.00
First National Bank—Minneapolis	645,000.00
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	\$23,865,000.00

All of said notes were in the same form except the name of the payee banks and the amount of the notes. There may be received in evidence a photostat copy of the first of these notes, to wit, the note to The New York Trust Co., New York, in the sum of \$3,225,000.00. These notes were as of November 23, 1949, outstanding except as reduced by payments on account.

Dated: June 15, 1951.

MOSS, LYON & DUNN,

/s/ By CHARLES B. SMITH,

Attorneys for Plaintiff.

FRESTON & FILES and

EUGENE D. WILLIAMS,

/s/ By EUGENE D. WILLIAMS,

Attorneys for Harry M. Warner, Jack L. Warner,
and Warner Bros. Pictures, Inc.

OLIVER B. SCHWAB and

ARTHUR LIVINGSTON,

/s/ By ARTHUR LIVINGSTON,

Attorneys for Milton Sperling and United States
Pictures, Inc. [31]

[Endorsed]: Filed June 18, 1951.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR LEAVE TO FILE
AMENDED AND SUPPLEMENTAL
COMPLAINT

To the Defendants, Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc., and to Their Attorneys, Freston & Files and Eugene D. Williams; to the Defendants, Milton Sperling and United States Pictures, Inc., and to Their Attorneys, Oliver B. Schwab and Arthur Livingston:

You and Each of You Will Please Take Notice that on Tuesday, March 17, 1953, at 10:00 a.m. of said day or as soon thereafter as counsel can be heard at the courtroom of the Honorable William Mathes located in the Federal Courthouse, Los Angeles, California, plaintiff Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, deceased, will move the court for leave to file an amended and supplemental complaint in the above entitled action. [32]

Said motion will be made upon the grounds that an amended and supplemental complaint is necessary in the interests of justice and to set forth matters occurring subsequent to the filing of the original complaint.

Said motion will be based on this notice, Memorandum of Points and Authorities, the proposed amended and supplemental complaint, a copy of which is served herewith and the papers, files, rec-

ords and minutes of the court in the within action.

Dated: March 13, 1953.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff. [33]

[Title of District Court and Cause.]

AMENDED AND SUPPLEMENTAL COM-
PLAINT (AFTER SEVERANCE OF THIRD
CAUSE OF ACTION) FOR ACCOUNTING
AND DAMAGES

Plaintiff Edward S. Birn having sued herein derivatively on behalf and for the benefit of defendant Warner Bros. Pictures, Inc., and the stockholders thereof, and upon his death the special administrator of his estate in California having, by order of this court, been duly substituted as party plaintiff, and plaintiff having first obtained leave of the courts so to do, now files this amended and supplemental complaint as follows: (All of the allegations below being upon information and belief except allegations "1" to "4", inclusive, and allegation "22" which are alleged as of plaintiff's knowledge.

For a First Cause of Action Against All
Defendants.

1. Jurisdiction herein is founded on diversity of citizenship and amount. This action is not a collu-

sive one to confer on [34] this court jurisdiction of an action over which it would not otherwise have jurisdiction.

2. The matter in controversy exceeds, exclusive of interest and costs, the sum of \$3,000.

3. Plaintiff's decedent was a citizen of the State of New York, and the estate of said decedent is in the course of probate in said state.

4. Plaintiff's decedent was during the time that the transactions herein complained of occurred, the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc., having owned said stock since August 21, 1944.

5. Defendants Warner Bros. Pictures, Inc., (hereinafter referred to as Warner Bros.) and United States Pictures, Inc., (hereinafter referred to as United) are corporations incorporated under the laws of the State of Delaware, engaged in the motion picture business and said corporations do business and maintain offices in the County of Los Angeles and State of California.

6. The defendants Milton Sperling, Harry M. Warner and Jack L. Warner are citizens of the State of California.

7. That during the time that the transactions hereinbelow complained of occurred, the defendants, Harry M. Warner and Jack L. Warner, were directors of Warner Bros.

8. That the following persons were directors of Warner Bros. during the periods stated after their respective names:

Harry M. Warner, 1923 to date; Jack L. Warner,

1923 to date; Albert Warner, 1923 to date; Waddill Catchings, 1925 to date; Morris Wolf, 1926 to date; Stanleigh P. Friedman, 1931 to date; Charles S. Guggenheimer, 1932 to date; Samuel Carlisle, 1934 to date; [35] Robert W. Perkins, 1936 to date; Samuel Schneider, 1944 to date; Joseph Bernhard, 1936 to September 10, 1950; John E. Bierwirth, November, 1945 to date.

9. That the aforementioned Harry M. Warner, Jack L. Warner and Albert Warner are brothers and the aforesaid Milton Sperling is the son-in-law of Harry M. Warner.

10. That at all times herein mentioned the defendants Harry M. Warner and Jack L. Warner, together with their brother Albert Warner owned a large and controlling block of the outstanding capital stock of Warner Bros. and said three brothers did control and dominate Warner Bros. and did actively direct its supervision, policies, actions and business including the acts hereinafter alleged in this complaint and did actually select, dominate and control the directors and officers of Warner Bros.

11. That in or about or prior to the summer of 1945 the individual defendants did illegally, wrongfully and in bad faith, conspire and act together and did conspire and still continue to conspire to waste, mismanage, divert and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling and United at the expense of Warner Bros. and regardless of the con-

sequences to Warner Bros. and each of the different things and acts done and being done by said individual defendants, and by the corporate defendants through their directors and officers, hereinbelow alleged, were, among others, and continue to be all steps in said conspiracy and were and are being committed pursuant thereto, and in furtherance of said objects. That in performing such acts and doing such things, defendants acted and continue to act unfairly to Warner Bros. and for the benefit of and advantage to United and Sperling; and the defendants Harry Warner and Jack Warner were and continue to be unfair and disloyal to their trust as directors and executive [36] officers of Warner Bros.

12. That on or about August 6, 1945, defendant United was caused to be organized with nominal capital contributions and the capital stock of said corporation was issued to Sperling and Joseph Bernhard, a Warner director who thereafter resigned from the Warner Board, severed his connection with Warner, and received \$78,000 in the form of "severance pay", though his employment contract with Warner contained no provision entitling Bernhard to severance pay. That since September 1946, defendant Sperling has been the sole stockholder of defendant United, with the exception of 62 shares of which he later assigned to the Title Insurance and Trust Company of Los Angeles to be held in trust for the benefit of his minor children.

13. That said corporation was organized in order that through it, the defendant Sperling might

wrongfully utilize and divert from Warner Bros. the funds, credits, facilities, assets and business opportunities of Warner for his private purpose and benefits to the disadvantage and detriment of Warner Bros.

14. In or about September, 1945, the defendants caused Warner Bros. and United to enter into an agreement, hereinafter referred to as the "basic agreement", which provided in substance as follows:

Six motion pictures were to be produced by United at the studio, and with the facilities and personnel of, Warner Bros. Said pictures were to be distributed by Warner Bros. through its subsidiaries, the latter to retain out of the gross proceeds of distribution certain percentages and sums as fees and expenses of distribution and the net profits from the production and distribution of said pictures were to be shared equally between Warner Bros. and United.

Warner Bros. was to advance 50% of the cost of production of said pictures and the remaining 50% of said cost was to be [37] advanced by United. In this latter connection, however, United was authorized to borrow its entire share of the cost of production and was further authorized to pledge, as security for such borrowing, the pictures to be produced, including the negatives and positive prints thereof and including the entire net proceeds of the distribution of said pictures, and Warner Bros. was to agree to such pledge and thereby subordinate its investment and provide with its funds the collateral security for the loan to United.

15. That at the time of the making of said agreement, it was intended by defendants that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of said six motion pictures by means of the borrowing privileges set forth in said agreement.

16. The defendants caused amendments to the basic agreement to be entered into between Warner Bros. and United. These amendments were dated November 2, 1945, May 20, 1946, December 6, 1947, December 9, 1947, July 21, 1950, and August 12, 1952. The amendments bearing date December 6, 1947, July 21, 1950 and August 12, 1952, provided, among other things, that Warner Bros. would advance 100% of the cost of a further series of motion pictures called "additional" pictures; that United would produce such additional pictures in the Warner studios; that in the production of such additional pictures, United would not be called upon to advance any of its own funds; that with respect to any picture produced by United after December 6, 1947, United would not be called upon to declare whether the same is being produced by it under the basic contract, unamended or whether it is being produced under the provisions of the said amendments, until the commencement of principal photography thereon.

17. That in furtherance of said basic agreement and intention as set forth in the preceding paragraphs and in or about [38] November, 1945, the

defendants caused an agreement to be entered into between Warner Bros. and United and The New York Trust Company (the latter being a New York banking corporation) for the loan by The New York Trust Company to United, of the latter's share of the cost of production of the pictures as aforesaid and under said agreement there was pledged as security for the repayment of said loans the security described in allegation "14" hereinabove and said basic agreement further provided that after said loans had been repaid and after the share of the production costs of the pictures advanced by Warner Bros. had likewise been repaid, the net profits resulting from the pictures were to be shared equally between Warner Bros. and United.

18. That said loan agreement was effectuated through the use of the valuable credit and banking facilities and connections of Warner Bros. in that John E. Bierwirth, a director of Warner Bros., is and has been president of The New York Trust Company since 1941, and his influence was used by Warner Bros. and Joseph Bernhard to effect said loan agreement, and further, in that Warner Bros. is a valued customer of The New York Trust Company and its patronage is favorably sought for various reasons including the fact that Warner Bros. was then indebted to a syndicate of banks, including The New York Trust Company, to the extent of several million dollars.

19. That in pursuance of said agreements as alleged in paragraphs numbered "14", "16" and "17" above, and during the period commencing in

or about November, 1945, to date, United has borrowed large sums from The New York Trust Company and the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being used by United, and the said agreements have been in part performed and motion pictures are being produced and distributed under said agreements and said agreements remain in part unperformed. [39]

20. That in connection with the performance of said agreements, United has not advanced any of its private funds or capital and has contributed to the costs of production of said pictures solely out of loans from The New York Trust Company.

21. Defendants have designed and contrived to cause said agreements between Warner Bros. and United to be performed in a manner unfair to Warner Bros. and to benefit and to further the interests of United and Sperling at the expense and to the detriment of Warner Bros. That said agreements have not been made, performed and administered as "arms length" transactions between Warner Bros. and United.

22. That plaintiff's decedent did not discover the facts set forth in allegations "11" to "21" inclusive, until October of 1948 and plaintiff's decedent had no notice or information of circumstances which would put him on inquiry regarding such facts until October of 1948. The causes of action herein alleged have been continuous from 1945 to date hereof.

23. That by reason of the premises, Warner

Bros. has suffered and still suffers improper and illegal waste, mismanagement, misappropriation and diversion of its valuable assets, credits, facilities and business opportunities all to its loss and to the improper and personal profit and benefit of United and Sperling, in that:

(a) The aforesaid agreements, the manner in which the same have been and are being performed and administered are grossly unfair to Warner Bros.; the amount of return or profit provided thereunder to Warner Bros. and the amount of distribution fees provided thereunder to its subsidiaries are grossly unreasonable and unfair to Warner Bros.; they are not in accordance with customary agreements in the motion picture industry; and (b) Warner Bros., in effect, has been and still is [40] providing the use of its funds, credits, facilities and assets to defendant United without any adequate, reasonable or legal consideration, return, or payment to Warner Bros.; and

(c) Warner Bros. in effect, has been and still is undertaking the sole risk of capital and bearing the entire burden of the cost of production of said motion pictures involved in the aforesaid agreement, and in the event of loss in said productions, Warner Bros. will suffer the entire or principal amount thereof inasmuch as United has advanced no capital and is financially unable to meet or share any substantial losses; and despite the foregoing, Warner Bros. receives only 50% of the net profits and the other 50% of the said profits goes to United and in addition thereto, the defendant

Sperling is assured a substantial annual salary which becomes part of the production costs of said pictures; such profit divisions are grossly unfair to Warner Bros. and the receipt by United of said profits and benefits or the receipt of said benefits by Sperling under said agreements constitutes an improper and unconscionable gift or advantage to United and to Sperling at the expense of Warner Bros.; and

(d) The subordination and use of the capital assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes an improper or illegal use of property of Warner Bros. for which the latter receives in return no legal, adequate or fair consideration; and

(e) The subordination and use of the capital, assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constitutes a breach of the existing written agreement between Warner [41] Bros. and a syndicate of banks under which Warner Bros. is the recipient of large business loans totalling several millions of dollars, and the said last named written agreement with said banks prohibits such use of the capital and assets of Warner Bros., and thereby Warner Bros. is endangering said loans and injuring its credit.

24. That all of the acts and matters alleged in this complaint were then known or with the exercise of reasonable diligence should have been then known to the defendants, and all of the defendants

either actively participated in said acts or matters or with knowledge of the same and the course of conduct being pursued, ratified said acts or matters or failed to take any corrective measures.

25. That by reason of the premises, the defendant United and its assets, and the profits and benefits derived by it from Warner Bros. under the above mentioned agreements, are substantially based upon, result from, and stand in the place of, the assets and business opportunities wrongfully diverted from Warner Bros. to United and hence the capital stock of United and all of its said assets belonging in equity and good conscience to Warner Bros.

26. Demand upon the directors of Warner Bros. to institute this action would be futile and plaintiff had made no such demand because all or a majority of the present Board of Directors and officers of said corporation wrongfully participated in the acts and grievances herein complained of and said Board of Directors is controlled by the active wrongdoers herein, and since those to whom application would have to be made to institute this suit are the same persons who wrongfully caused or permitted the grievances herein complained of, such persons would refuse to bring suit against themselves and in fact would be disqualified from faithfully doing so.

27. Plaintiff's decedent has made no demand upon the [42] stockholders of Warner Bros. because under the laws of Delaware the management of Warner Bros. is directed by its Board of Directors

and the stockholders cannot bring suit for Warner Bros., nor require the Board of Directors to bring such suit; and further because the defendants Jack L. Warner and Harry M. Warner and their brother Albert Warner hold upwards of sixteen per cent (16%) of the total issued stock of Warner Bros. and the balance of such stock is held by upwards of thirty thousand (30,000) stockholders widely scattered over the United States and foreign countries, so that such demand would entail a prohibitive cost and expense to the plaintiff while the management of Warner Bros. could and would defend its position by the use of its corporate funds and facilities which management is dominated and controlled by the wrongdoers herein.

28. Plaintiff has no adequate remedy at law and he and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted.

For a Second Cause of Action Against All Defendants Except United and Sperling.

29. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "28" (except ("11")), inclusive, with the same force and effect as though herein alleged.

30. That by reason of the acts committed by these defendants as herein alleged, the individual defendants, while acting in their fiduciary capacities and while charged with their fiduciary duties as direc-

tors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, nonfeasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

Wherefore, plaintiff demands judgment as follows: [43]

(1) That the defendants account to Warner Bros. for all losses and damages suffered by it and for all profits and benefits received by said defendants, and that defendants make restitution accordingly.

(2) That a trust be impressed upon the capital stock and assets of United in favor of Warner Bros.

(3) That the agreement between Warner Bros. and United to the extent that the same is unexecuted and to the extent that it is practicable to do so, should be cancelled and terminated.

(4) That defendants Harry M. Warner and Jack L. Warner make whole Warner Bros. Pictures, Inc. for all damages that it has suffered because of such defendants' successive breaches of their fiduciary duty to Warner Bros. Pictures, Inc., or arising out of the same, and because of their illegal and wrongful acts herein alleged.

(5) That plaintiff be allowed the costs, disbursements and expenses of this action, including reasonable counsel and accountants fees.

(6) That such other and further relief be granted as shall be equitable in the premises.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
By HERMAN H. LEVY,
Attorneys for Plaintiff. [44]

Duly Verified. [45]

Affidavit of Service by Mail attached. [46]

[Endorsed]: Filed March 13, 1953.

[Title of District Court and Cause.]

ORDER DENYING MOTION FOR LEAVE TO
FILE AMENDED AND SUPPLEMENTAL
COMPLAINT

The above-entitled matter came on regularly before the undersigned William C. Mathes, District Judge, at his courtroom in Los Angeles, California, on March 17, 1953, at 10 o'clock a.m., plaintiff being represented by Messrs. Moss, Lyon and Dunn and Herman H. Levy, his attorneys, the defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. being represented by their attorneys, Messrs. Freston & Files and Eugene D. Williams, and the defendants Milton Sperling and United States Pictures, Inc. being represented by their attorney, Oliver B. Schwab:

Motion for leave to file an amended and supplemental complaint was made on behalf of the plaintiff, written objections were filed by the defendants Warner, above-named, and oral objections were

made by the defendants Milton Sperling and United States [52] Pictures, Inc., above-named; the matter was argued and submitted to the Court, and the Court having duly considered said motion and the objections thereto and the arguments of counsel:

It Is Ordered that said motion for leave to file amended and supplemental complaint be, and the same is, hereby denied; without prejudice, however, to the plaintiff making a motion at an appropriate time for leave to amend to conform to the proof as permitted by Rule 15(b) of the Rules of Civil Procedure.

Done in open court March 17, 1953.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES and
EUGENE D. WILLIAMS,

/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner.

Approved as to form this 18th day of March,
1953.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.

OLIVER B. SCHWAB,

/s/ By OLIVER B. SCHWAB,
Attorney for Defendants Milton Sperling and United States Pictures, Inc.

[Endorsed]: Filed March 23, 1953.

[Title of District Court and Cause.]

STIPULATION CONCERNING OTHER STOCKHOLDERS' CASES

It Is Stipulated that the following is the status of the cases filed in New York which involve generally the set of facts involved in the above action:

Pending in the United States District Court, Southern District of New York: [54]

William B. Weinberger vs. Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed September 24, 1948, case dismissed December 31, 1951, but can be restored upon ten days' notice.

Anna Kassner vs. United States Pictures, Inc., Warner Bros. Pictures, Inc., Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner and Morris Wolf, complaint filed September 30, 1948, action dismissed upon stipulation January 11, 1951.

Irving W. Mencher vs. Harry M. Warner, Jack L. Warner, Milton Sperling, Robert W. Perkins, Morris Wolf, Joseph Bernhard, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed October 5, 1948, case dismissed upon stipulation January 11, 1951.

Annie Fastenberg vs. Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Morris Wolf, United States Pic-

tures, Inc., and Warner Bros. Pictures, Inc., complaint filed October 7, 1948, action dismissed upon stipulation January 12, 1951.

Kate Lavine vs. Robert W. Perkins, Harry M. Warner, Joseph Bernhard, Jack L. Warner, Milton Sperling, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed October 11, 1948, dismissed for lack of prosecution by order of Judge Knox, June 19, 1950.

Edward S. Birn vs. Milton Sperling, Joseph Bernhard, Harry M. Warner, Jack L. Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed November 12, 1948, dismissed by order of Judge Alfred C. Coxe, January 19, 1951, upon ground that case had abated under Rule 1 of Court Rules.

Bernard M. Geller vs. Jack L. Warner, Milton Sperling, Morris Wolf, Harry M. Warner, Robert W. Perkins, Joseph Bernhard, [55] United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed December 10, 1948, action dismissed upon stipulation January 18, 1951.

Abraham Fistel vs. John E. Bierwirth, Samuel Schneider, Samuel Carlisle, Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Albert Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed January 27, 1949, dismissed without prejudice June 18, 1953.

Lawrence B. Dottenheim vs. Milton Sperling,

Harry M. Warner, Jack L. Warner, Joseph Bernhard, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., complaint filed March 9, 1949, case removed from calendar and from pre-trial calendar November 17, 1952, but can be restored on ten days' notice.

Filed in the Supreme Court of New York County, New York:

William B. Weinberger vs. John E. Bierwirth, Samuel Carlisle, Waddill Catchings, Stanleigh P. Friedman, Charles S. Guggenheimer, Samuel Schneider, Albert Warner, and Warner Bros. Pictures, Inc., commenced September 28, 1948 as to Catchings; October 7, 1948 as to Carlisle and Warner Bros. Pictures, Inc.; October 11, 1948, as to Schneider; October 18, 1948 as to Albert Warner; October 29, 1948 as to Friedman. Order for bond in sum of \$50,000 has not been complied with and action stayed. Case not on calendar.

Anne Goodfriend vs. Jack L. Warner, Milton Sperling, Morris Wolf, Harry M. Warner, Robert W. Perkins, Joseph Bernhard, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 8, 1948, by service on Warner Bros. Pictures, Inc., and on January 10, 1949, as against Robert W. Perkins. Order for security in sum of \$25,000 granted, and extending time to answer has not been complied with; case not on calendar.

William B. Weinberger vs. Milton Sperling, Jo-

seph Bernhard, [56] United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 20, 1948 by service on Warner Bros. Pictures, Inc., order for security bond in sum of \$25,000 and extending time to answer not complied with; case not on calendar.

Annie Fastenberg vs. Joseph Bernhard, Milton Sperling, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 21, 1948 by service on Warner Bros. Pictures, Inc. of summons without complaint. Complaint has never been served and action is not on calendar.

Anna Kassner vs. Joseph Bernhard, Milton Sperling, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced December 21, 1948 by service on Warner Bros. Pictures, Inc., order for bond in sum of \$25,000 and extending time to answer has not been complied with; case not on calendar.

Irving W. Mencher vs. Milton Sperling, Joseph Bernhard, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced January 3, 1949 by service on Warner Bros. Pictures, Inc., order for bond in sum of \$25,000 and extending time to answer not complied with; case not on calendar.

Harry Rattner vs. John E. Bierwirth, Samuel Schneider, Samuel Carlisle, Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Albert Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros.

Pictures, Inc., commenced February 25, 1950 by service on Warner Bros. Pictures, Inc.; March 1, 1950, as to Carlisle; March 14, 1950, as to Bierwirth. Order for security bond in the sum of \$75,000 has not been complied with; case not on calendar.

Abraham Fistel vs. John E. Bierwirth, Samuel Schneider, Samuel Carlisle, Joseph Bernhard, Robert W. Perkins, Milton Sperling, Harry M. Warner, Jack L. Warner, Albert Warner, Morris Wolf, United States Pictures, Inc., and Warner Bros. Pictures, Inc., action commenced March 2, 1950, against Warner Bros. Pictures, and on [57] April 26, 1950, against Bernhard. Answer for Warner Bros. Pictures, Inc. served June 21, 1950. Amended answer on July 13, 1950. Case is not on calendar.

Lawrence B. Dottenheim vs. Milton Sperling, Joseph Bernhard, Albert Warner, Harry M. Warner, Morris Wolf, Robert W. Perkins, Samuel Schneider, Samuel Carlisle, Waddill Catchings, Stanleigh P. Friedman, Charles S. Guggenheimer, John E. Bierwirth, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., commenced as against Sperling March 22, 1950; as against Guggenheimer June 16, 1950; as against Catchings June 27, 1950; as against Bierwirth June 27, 1950; as against Warner Bros. Pictures, Inc. December 6, 1950. Answer served by Sperling on June 14, 1950; by Guggenheimer on July 7, 1950; by Catchings and Bierwirth on July 17, 1950; by Warner Bros. Pictures, Inc. on December 27,

1950. Motion to traverse service as to United States Pictures, Inc., referred to Referee. Case has not been placed on calendar.

Dated: July 3, 1953.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff

/s/ OLIVER B. SCHWAB,
Attorney for the Defendants Milton Sperling and
United States Pictures, Inc.

FRESTON & FILES and
EUGENE D. WILLIAMS,
/s/ By EUGENE D. WILLIAMS,
Attorneys for Warner
Defendants. [58]

[Endorsed]: Filed July 14, 1953.

[Title of District Court and Cause.]

PLAINTIFF'S OBJECTIONS TO FINDINGS
OF FACT AND CONCLUSIONS OF LAW

Comes Now the plaintiff and files his objections to the proposed Findings of Fact and Conclusions of Law as prepared by counsel for the defendants and files herewith his Statement of Objections to such Findings of Fact and Conclusions of Law and reasons therefor, as follows:

I.

Objection to Proposed Finding No. III.

Plaintiff objects to that portion of proposed finding No. III (page 3, lines 3-7) viz:

“That this action was commenced by Edward S. Birn as the owner of four hundred shares of the capital stock of the defendant Warner Bros. Pictures, Inc., and that he is suing derivatively on behalf of and for the benefit [135] of said defendant Warner Bros. Pictures, Inc., and the stockholders thereof;”

on the ground that this finding fails to incorporate a finding to the effect that Birn owned 400 shares during the period complained of.

Plaintiff objects to this finding on the ground that it is incomplete in that it omits to make a finding as to what constitutes the “principal purpose of the suit” (see Opinion of the Court, page 51, in which the Court says: “The ‘matter in controversy’ referred to in 28 U.S.C. Sec. 1332 must be ascertained from the ‘principal purpose of the suit.’”) And plaintiff requests that the following be added (beginning on line 7 of page 3 following the word “thereof”):

“The principal purpose of the suit was to obtain judicial scrutiny of the facts involved in the negotiation, execution and performance of a contract, and a series of three amendments which had been entered into by the corporate defendants prior to the filing of the suit; under the terms of which agreements the Warner corporation, a publicly owned company headed by Harry Warner as Presi-

dent, had participated in a series of profit-sharing transactions with United, a company which was formed for the purpose of engaging in these transactions and whose stock was owned by members of Harry Warner's family, to-wit: during the first year of United's existence, its stock was owned by defendant Sperling and one Joseph Bernhard, a former officer and director of the Warner corporation; thereafter, and at the time of the filing of the suit, it was owned by Sperling and his two infant children who are Harry Warner's grandchildren; with a view:

(a) to adjudicating the merits of plaintiff stockholder's claim which is substantially:

1. Self-dealing and overreaching to favor members of Harry Warner's family, permeated the formation of United and the negotiation, execution and performance of said agreements;

2. The terms of the contract and of the amendments were unfair to the Warner corporation; they were unwarrantedly favorable to United and Sperling and were performed in a manner unwarrantedly favorable to United and Sperling and unfair to the Warner corporation.

3. Throughout the Warner corporation's participation with United in those profit-sharing transactions, Harry and Jack Warner together with their brother Albert Warner actively directed the supervision, policies, acts and business of the Warner corporation;

4. Negotiations which were not conducted at "arms length", designed and channeled by Harry

Warner to unwarrantedly favor United and Sperling at Warner corporation's expense, with Harry Warner actively participating therein, preceded the formation of United and the drawing and signing of the contracts and the amendments;

5. Harry and Jack Warner with intent to favor Sperling; to further and enrich Sperling's private interests at Warner corporation's expense, suffered and countenanced the contract and the amendments, to contain terms unfair to the Warner corporation; and to be performed in a manner unwarrantedly favorable to United and Sperling and unfair to the Warner corporation; and furthermore, in a manner contrary to the terms of the agreements;

6. With like intent, Harry and Jack Warner, recommended that the Warner Board approve the contract (it is hereinafter referred to as the master contract) and following such recommendation, obtained the Board's approval; [137]

7. The suit was commenced on December 15, 1948; one of the amendments was signed by the corporate defendants on December 6, 1947; Harry and Jack Warner negotiated the terms of this amendment and caused the Warner corporation to sign it; the amendment materially altered the terms of the master contract; as altered, the terms of the amendment were increasingly unfair to the Warner corporation and unwarrantedly favorable to United and Sperling and one of the profit-sharing transactions, namely, the production and distribution of a picture entitled "South of St. Louis" was par-

ticipated in by the corporate defendants on the terms set forth in this amendment;

8. Neither before this amendment was signed by the Warner corporation nor during such production and distribution and up to the filing of the suit, had Harry and Jack Warner sought nor obtained the Warner Board's approval thereof or authorization to cause it to be signed.

9. At the time this amendment was signed and during the nine months which preceded its signing and at the time this suit was filed, Harry Warner individually, had a financial interest in United, to-wit: United had theretofore borrowed \$150,000 from a bank; had executed a demand promissory note payable to the bank in that sum; Harry Warner had endorsed the note and the loan was then unpaid;

10. At the time that this amendment was signed and for more than one year before, and at the time this suit was filed, Harry Warner's daughter, Betty Sperling, was financially interested in United, to-wit: In September of 1946, Sperling purchased Bernhard's stock interest [138] in United for \$400,000 in cash and thereby became the owner of all of United's outstanding stock; Sperling borrowed this money from the same bank and deposited as collateral, securities owned by Betty Sperling; on December 6, 1947, the loan was unpaid and the collateral was still in the possession of the bank;

11. At the time that this amendment was signed

and for approximately one year before, Harry Warner's grandchildren, being the children of Betty and Milton Sperling, had a financial interest in United, to-wit: In December of 1946, Sperling transferred 62 shares of United stock to Title Insurance & Trust Company, a California corporation, as Trustee for the benefit of his children, and Harry Warner knew of such interest when this amendment was signed.

12. Before the master contract was signed by the corporate defendants, Joseph Bernhard was a resident of New York State and was an officer, director in and was employed by the Warner corporation under a written contract of employment; in negotiations which preceded the drawing and signing of the master contract, it was arranged between Harry Warner and Bernhard that Bernhard form United; that he and Sperling own its stock; that Bernhard's contract of employment with the Warner corporation be terminated; that Bernhard resign as an officer and director; that Warner corporation grant him \$78,000 as "severance pay", although his employment contract contained no provision obligating the Warner corporation to make such payment.

13. That three days before the master contract was signed, the Warner Board of Directors unlawfully authorized a grant to Bernhard of \$78,000, and unlawfully paid him [139] \$78,000.

14. That neither the master contract nor any of the amendments, nor the \$78,000 grant to Bern-

hard was submitted to the stockholders of the Warner corporation for their approval; accordingly, the contract, the amendments and the payment to Bernhard were not approved by the stockholders.

15. Harry and Jack Warner, together with their brother Albert Warner, dominated and controlled the Warner Board; they selected, dominated and controlled the other directors on the Board.

16. That the Warner corporation has suffered and will suffer injury and damage as a result of the company's participation in these transactions.

17. It would have been futile for the plaintiff stockholder to demand of the Warner corporation and its directors that they act to remedy the wrongs asserted in plaintiff stockholder's claim; to institute this suit and obtain relief which to the court may seem just. Had the plaintiff addressed such demand to the corporation and its directors, they would have refused to act thereon.

18. Plaintiff stockholder did not address such demand to the stockholders of the Warner corporation for the reason that the stockholders number some 30,000; they are located in various states of the United States and in foreign countries all over the world; and it would accordingly be virtually impossible and impractical to obtain concerted action by the stockholders.

19. Plaintiff did not collude with defendants, or any of them, for the purpose of creating a case cognizable by this Court. [140]

II.

Objection to Proposed Finding No. IV.

Plaintiff objects to that portion of finding No. IV (page 3, lines 25-30), viz:

“that the contract in controversy and all amendments and supplements thereto were and are sound business arrangements made and entered into in good faith and without fraud, and said contract and amendments and supplements thereto were of benefit to Warner Bros. Pictures, Inc. and its stockholders,”

on the ground that it purports to adjudicate that the master contract and all its amendments and supplements, viz: those executed and negotiated before and after the commencement of the suit, were in all respects legal and fair to the Warner corporation and were performed in a manner fair to said company and resulted in benefit to said company.

The Court's written opinion (page 54) contains no language which indicates, in words or substance, that the Court has adjudicated issues bearing on the legality or illegality of the master contract or amendments and supplements thereto; the fairness or unfairness to the Warner corporation thereof; the fairness or unfairness to the Warner corporation of the manner in which the contract or its amendments were performed or whether or not the Warner corporation suffered and countenanced breaches thereof by United; and whether the Warner corporation benefited or was injured.

Plaintiff objects to that portion of finding No. IV, (page 3, lines 30-32 and page 4, lines 1-5), viz:

“said contract and said amendments and supplements thereto were considered by said eleven members of the Board of Directors of Warner Bros. Pictures, Inc. to be a sound business arrangement for the best present and future interests of the corporation; that in approving [141] and authorizing the contract and said amendments and supplements thereto, the officers and Board of Directors acted in good faith and exercised their independent business judgment.”

on the grounds (a) that the presence or absence of jurisdiction of the subject matter is determined by the factual situation at the time of the filing of the suit; that embraced in this portion of the proposed finding are amendments and supplements to the master contract entered into after suit was commenced, namely, the amendment dated July 21, 1950, (Exhibit 7 in evidence), and the amendment dated August 12, 1952, (Exhibit 107, last page, in evidence); (b) the amendment to the master contract dated December 6, 1947, was not presented to any meeting of the Warner Board nor did said agreement receive the Board's approval at any time before the suit was filed. Following a meeting of the Warner Board held on June 18, 1945, there was no meeting of the Board at which any matter concerning Warner-United relations was taken up or presented for Board consideration until August 17, 1950, or some two years after the suit was filed, (see

Stipulation of Facts, June 15, 1951, page 5, Section 7): (c) that this portion of the proposed finding does not conform to the first finding contained on page 54 of the Court's opinion, in that the purport of the Court's finding is that the Warner Board of Directors, as a Board, considered the contract in controversy to be a sound business arrangement for the best present and future interests of the corporation.

The purport of the proposed finding is and connotes that every individual director, including the brothers Warner, believed the contract in controversy, and all amendments and supplements thereto, to be fair to the Warner corporation.

Plaintiff further objects to that portion of finding No. IV, (page 4, lines 2-5) viz:

"that in approving and authorizing the contract and said amendments and supplements thereto, the officers and Board of Directors acted in good faith and exercised their independent business judgment."

on the grounds: (a) that as hereinabove pointed out, the above quoted portion does not conform to the Court's Opinion (page 54) in that the purport of the Court's finding is, that in approving and authorizing the master contract and such amendments thereto as were actually presented for Board approval in regular or special Board meetings, those members of the Board who voted to approve and authorize such contracts and such amendments—other than the three Warner brothers who were alleged to have dominated and controlled them—believed in good faith that the documents which they

approved and authorized were sound business arrangements for the best future interests of the corporation and they exercised their individual judgment in accordance with such belief.

The purport of the proposed finding is and connotes that not only did those directors so believe and in good faith exercise their independent judgment in accordance therewith, but that the three Warner brothers as well, so believed and were virtuous and sincere in that belief.

Plaintiff objects to that portion of proposed finding No. IV (page 4, lines 5-8) viz:

"That at the time of the execution of the contract, Albert Warner, together with the defendants Harry M. Warner and Jack L. Warner, owned only about fifteen per cent of the outstanding shares of stock of Warner Bros. Pictures, Inc.,"

on the ground that it fails to conform to the Court's Opinion (page 54) in that the figure fixed therein is "less than 20%".

Plaintiff objects to that portion of proposed finding No. IV (page 4, lines 11-13), viz:

"That neither the stockholders, its officers or [143] directors were, at any time involved in this action, antagonistic to the interests of the corporation."

on the ground that the same is not a finding of fact, but is rather a conclusion of law.

III.

Objection to Proposed Finding No. V.

Plaintiff objects to that portion of this finding (page 4, lines 15-18), viz:

"That it is not true either as alleged in the complaint, or otherwise, that all or a majority or any of the Board of Directors and officers of Warner Bros. Pictures, Inc. wrongfully participated in the acts and grievances in the complaint complained of,"

on the ground that (1) it is ambiguous: (2) it does not conform to the Court's Opinion (page 54) for the reasons hereinbefore set forth on Page 9, lines 4 to 20, of these objections.

Plaintiff objects to that portion of this finding (page 4, lines 18-21), viz:

"nor was said Board of Directors dominated or controlled by Harry M. Warner, Jack L. Warner, Albert Warner, Milton Sperling, or any one or more of them."

on the ground that by including the name of Milton Sperling, the same does not conform to the Court's Opinion.

Plaintiff objects to those portions of this finding (page 4, lines 21-30), viz:

"It is not true that if demand was made upon Warner Bros. Pictures, Inc., that those to whom such application would be made to institute such suit would have permitted the alleged grievances in said complaint complained of, if such existed, to continue or that they, or any of them, would be or were disqualified from

faithfully doing their duty as directors [144] and officers of said corporation because of any matters or facts set forth in said complaint, or otherwise. That no demand was made on the directors of said Warner Bros. Pictures, Inc. to institute this action nor was any demand addressed to the stockholders of said corporation."

on the ground (1) they are ambiguous; (2) they do not conform to the Court's Opinion; (3) if any finding bearing on the content of these proposed portions should be made, it should include a finding on the truth of that portion of plaintiff's claim hereinabove set forth on page 6, lines 15 to 31 of these objections.

Plaintiff objects to that portion of proposed finding No. V (page 4, lines 30-32 and page 5, line 1), viz:

"That the stockholders of said corporation were not at the time of the execution of the contract complained of or at any time or at all under the domination or control of the three brothers Warner,"

on the ground that the same is incomplete and if incorporated into these findings, should be complemented with a finding on that portion of plaintiff stockholder's claim herein contained on page 6, lines 2 to 7, of these objections.

Plaintiff objects to that portion of the proposed findings (page 5, lines 1-4), viz:

"nor was said corporation at any time herein referred to in hands or under control antagon-

istic to the interests of said corporation and its stockholders.”

on the ground that the same is not a finding of fact, but is rather a conclusion of law.

Plaintiff objects to those portions of finding No. V (page 5, lines 5-14), viz:

“That because of the foregoing findings of fact, [145] Warner Bros. Pictures, Inc. should be by the Court realigned as a party plaintiff and that upon such realignment it appears that a plaintiff, Warner Bros. Pictures, Inc., is a citizen of the State of Delaware, and that the defendant, United States Pictures, Inc. is a citizen of the State of Delaware.

That the sole basis of the jurisdiction of this Court is the claim set forth in the complaint of diversity of citizenship and that in view of the realignment of the parties in accordance with these findings, such diversity does not exist.”

on the ground that the same are not findings of fact, but are rather conclusions of law.

IV.

Objection to Proposed Finding No. II of the Second Cause of Action.

Plaintiff objects to this proposed finding on the ground that it is not a finding of fact, but is rather a conclusion of law.

V.

Objections to Conclusions of Law as to the Second Cause of Action.

Plaintiff objects to conclusions of law Nos. 2, 3, 4, 5 and 6 on the ground that they do not conform to the Court's Opinion in that the Court, in its Opinion, has concluded to dismiss the second cause of action, not on the ground that it lacks jurisdiction, but on the ground that the same is without equity.

VI.

Objection to the Proposed Judgment.

Plaintiff requests the Court to direct that each side bear its own costs for the reason that it would be consonant with equity so to do under the facts and the uncertainty of the law on the question of this Court's jurisdiction.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY [146]

Affidavit of Service by Mail attached. [147]

[Endorsed]: Filed January 19, 1954.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action came on regularly for trial the 7th day of April, 1953, in the above-entitled Court, Hon. William C. Mathes, District Judge presiding. Plaintiff was represented by Messrs. Moss, Lyon & Dunn and Herman H. Levy,

Esq., defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. were represented by Messrs, Freston & Files, Eugene D. Williams, Esq. and Joseph D. Karp, Esq., and defendants Milton Sperling and United States Pictures, Inc. were represented by Oliver B. Schwab, Esq.

The third cause of action set forth in the complaint was dismissed by the Court without prejudice prior to trial and no findings are herein made with reference thereto.

It appearing to the Court that the issues as to whether this Court has jurisdiction of the subject matter of the action and as to whether the action is barred by the applicable statute of [148] limitations are presented by the pleadings and that said issues should be disposed of in advance of a trial of the other issues in the case, it was ordered that the two issues, (1), as to whether this Court has jurisdiction of the subject matter of the action and (2) as to whether the causes of action are barred by the provisions of the applicable statute of limitations should be tried in advance of the trial of the other issues, and it was ordered that both parties present evidence only as to those two issues.

Thereupon, evidence on behalf of plaintiff and defendants was offered and received, the cause argued and submitted to the Court upon the two above stated issues only. The Court having duly considered the evidence and the law, and being fully advised in the premises, now files the following as its Findings of Fact and Conclusions of Law herein:

Findings of Fact

As to the First Cause of Action, the Court Finds:

I.

That this action was commenced by Edward S. Birn, a citizen of the State of New York, and since the commencement of said action, said Edward S. Birn has died and Charles B. Smith, as special administrator of the estate of Edward S. Birn, deceased, has been substituted in his place as plaintiff. That said Charles B. Smith is a citizen of the State of California.

II.

That defendants Harry M. Warner, Jack L. Warner and Milton Sperling, and each of them, are citizens of the State of California, and that the defendants Warner Bros. Pictures, Inc. and United States Pictures, Inc. are, and each of them is, a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and is a citizen of the State of Delaware; and that as the parties are aligned by the plaintiff, it appears that the plaintiff is a citizen of the State of New York and that the defendants are citizens [149] of the states of California and Delaware, as hereinbefore stated.

III.

That this action was commenced by Edward S. , during the period of the transactions chal-

lenged in the complaint. [Mathes, J.]

Birn as the owner ^A of four hundred shares of the capital stock of the defendant Warner Bros. Pic-

tures, Inc., and that he is suing derivatively on behalf of and for the benefit of said defendant Warner Bros. Pictures, Inc., and the stockholders thereof; that by the prayer of the complaint a trust is sought to be impressed on the capital stock and assets of United States Pictures, Inc., in favor of Warner Bros. Pictures, Inc., the agreement between said Warner Bros. Pictures, Inc. and United States Pictures, Inc. referred to in the complaint is sought to be cancelled and terminated and that the defendants Milton Sperling, Harry M. Warner, Jack L. Warner and United States Pictures, Inc. be required to account to Warner Bros. Pictures, Inc., for all losses and damages suffered by it and its subsidiaries and all profits and benefits received by said defendants and that said defendants make restitution accordingly. That the claim set forth in the first cause of action of the complaint, and relief sought, are for and on behalf of the defendant Warner Bros. Pictures, Inc., and that the said Warner Bros. Pictures, Inc. is the real party in interest in said cause of action.

IV.

That the Board of Directors of Warner Bros. Pictures, Inc. is composed of eleven men of whom the defendants Harry M. Warner, Jack L. Warner and their brother Albert Warner, are but three; that

was [Mathes, J.]

the contract in controversy [^] and all amendments and supplements thereto were and are sound busi-

~~ness arrangements made and entered into in good~~
faith and without fraud, and said contract ^{was} ~~and~~
intended by the directors to be [Mathes, J.]
~~amendments and supplements thereto were of~~
financial [Mathes, J.]
[^] benefit to Warner Bros. Pictures, Inc. and its
stockholders, and said contract ^{was} ~~and said amend-~~
~~ments and supplements thereto were~~ considered by
said eleven members of the Board of Directors of
Warner Bros. Pictures, Inc, to be a sound [150]
business arrangement for the best present and fu-
ture interests of the corporation; that in approv-
ing and authorizing the contract ~~and said amend-~~
~~ments and supplements thereto~~, the officers and
Board of Directors acted in good faith and exercised
their independent business judgment. That at the
time of the execution of the contract, Albert Warner,
together with the defendants Harry M. Warner and
less than twenty [Mathes, J.]
Jack L. Warner, owned [^] ~~only about fifteen~~ percent
of the outstanding shares of stock of Warner Bros.
Pictures, Inc., and that neither the corporation nor
the directors or officers were shown to be at that
time or at any time under the domination or control
of the three brothers Warner above named. That
neither the stockholders, its officers or directors were,
at any time involved in this action, antagonistic to
financial [Mathes, J.]
the [^] interests of the corporation.

V.

That it is not true either as alleged in the complaint, or otherwise, that all or a majority or any of the Board of Directors and officers of Warner Bros. Pictures, Inc. wrongfully participated in the acts ~~and grievances~~ in the complaint complained of, nor was said Board of Directors dominated or controlled by Harry M. Warner, Jack L. Warner, Albert Warner, Milton Sperling, or any one or more

had been [Mathes, J.]
of them. It is not true that if demand [^] ~~was~~ made upon Warner Bros. Pictures, Inc., that those to whom such application would be made to institute

been [Mathes, J.]
such suit would have [^] ~~permitted the alleged griev-~~
~~ances in said complaint complained of, if such ex-~~
~~isted, to continue or that they, or any of them,~~
would be or were disqualified from faithfully doing their duty as directors and officers of said corporation because of any matters or facts set forth in said complaint, or otherwise. That no demand was made on the directors of said Warner Bros. Pictures,

and such a demand would have been futile;
Inc. to institute this action [^] nor was any demand addressed to the stockholders of said corporation. That the stockholders of said corporation were not at the time of the execution of the contract complained of or at any time or at all under the [151] domination or control of the three brothers Warner; nor was said corporation at any time herein

referred to in hands or under control antagonistic financial [Mathes, J.] to the ^A interests of said corporation and its stockholders.

That because of the foregoing findings of fact, Warner Bros. Pictures, Inc. should be by the Court realigned as a party plaintiff and that upon such realignment it appears that a plaintiff, Warner Bros. Pictures, Inc., is a citizen of the State of Delaware, and that the defendant, United States Pictures, Inc. is a citizen of the State of Delaware.

That the sole basis of the jurisdiction of this Court is the claim set forth in the complaint of diversity of citizenship and that in view of the realignment of the parties in accordance with these findings, such diversity does not exist.

As to the Second Cause of Action, the Court Finds:

I.

Repeats and hereby incorporates all of the preceding findings of fact and applies the same to the second cause of action set forth in the complaint.

II.

That the second cause of action presents a claim for, on behalf of and for the benefit of Warner Bros. Pictures, Inc.; that the plaintiff in the complaint has not included the defendant United States Pictures, Inc. as a defendant in the second cause of action; that complete relief as sought in the second cause of action cannot be accorded between those

now named as parties without the inclusion as a party defendant of United States Pictures, Inc.;

the financial interest therein of United States Pictures, Inc. [Mathes, J.]

that ^Δ this Court, as a court of equity, cannot proceed to final decision without United States Pictures, Inc. as a defendant because the interests of and extent [Mathes, J.] ~~such corporation~~ is of such ~~a~~ nature ^Δ that a final decree cannot be made without affecting that interest or leaving the controversy in such condition that its final determination may be wholly [152] inconsistent with equity and good conscience. That United States Pictures, Inc. is a party so indispensable in this action that a court of equity will not proceed to final judgment without it; and without said corporation as a party defendant, the cause is without equity.

Conclusions of Law

And As Conclusions of Law Based Upon the Foregoing Findings of Fact, This Court Finds and Concludes As Follows:

I.

That the first cause of action sets forth a claim solely for the benefit of Warner Bros. Pictures, Inc., and that said corporation is an indispensable party to said cause of action.

II.

That Warner Bros. Pictures, Inc., its stockhold-

ers, directors and officers are not dominated by the defendants Harry M. Warner, Jack L. Warner and their brother Albert Warner, or any of them, and that said corporation is not and has not been in the hands or under the control of persons antagonistic to the interests of said corporation in said action.

III.

That Warner Bros. Pictures, Inc. should be realigned as a party plaintiff. That upon such realignment, Warner Bros. Pictures, Inc., being a citizen of the State of Delaware, and the defendant United States Pictures, Inc., being a citizen of the State of Delaware, there is no diversity of citizenship and that by reason thereof this Court has no jurisdiction of the subject matter of said action.

As to the Second Cause of Action, the Court Finds and Concludes:

I.

That United States Pictures, Inc. has an interest in the subject matter of the second cause of action of such nature that a [153] final decree cannot be made without either affecting that interest or leaving the controversy in such a condition that final determination may be inconsistent with equity and good conscience and therefore the Court finds that United States Pictures, Inc. is a party so necessary and indispensable that a court of equity will not proceed to determination without it; and that without said corporation as a party, the cause of action is without equity.

II.

That as to the second cause of action, Warner Bros. Pictures, Inc., a citizen of the State of Delaware, should be aligned as a party plaintiff and ~~that~~ United States Pictures, Inc., a citizen of the State

would, if joined [Mathes, J.] of Delaware, ~~should~~[^] be aligned as an indispensable party defendant; and ~~that~~ upon such realign-

would be [Mathes, J.] ment, there [^] ~~is~~ no diversity of citizenship as between the parties plaintiff and defendant.

III.

~~That by reason of the foregoing, this Court is without jurisdiction of the subject matter of said second cause of action.~~

IV.—

As to both causes of action, the Court finds and concludes that upon proper realignment of indispensable [Mathes, J.]

the [^] parties, Warner Bros. Pictures, Inc., a Delaware corporation and citizen of the State of Delaware, becomes a party plaintiff, while United States Pictures, Inc., a Delaware corporation and citizen of the State of Delaware, is a party defendant, and that thereby there is no diversity of citizenship as between the parties plaintiff and defendants.

IV.

That there is no claim or showing of Federal jurisdiction of this Court other than the claim of diversity of citizenship and that therefore this Court

the first cause of
is without jurisdiction of the subject matter [^] of ~~this~~
and the second cause of action must be dis-
missed for want of equity [Mathes, J.]
action; [^]

V.

the [Mathes, J.]
That [^] ~~this Court is without jurisdiction and that~~
~~therefore the action should be dismissed, and such~~
~~judgment of dismissal shall expressly declare that~~
constitute an [Mathes, J.]
it does not [^] ~~operate as~~ adjudication upon the
merits and is without prejudice or res judicata
effect.

of dismissal [Mathes, J.]
Let judgment [^] be entered accordingly.

Done in Open Court This 21st Day of January,
1954.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES;
EUGENE D. WILLIAMS and
JOSEPH D. KARP,

/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner. [155]

Affidavit of Service by Mail attached. [156]

[Endorsed]: Lodged December 24, 1953.

[Endorsed]: Filed January 21, 1954.

United States District Court for the Southern
District of California, Central Division.

No. 9005-WM Civil

CHARLES B. SMITH, as Special Administrator
of the Estate of Edward S. Birn, Deceased,
Plaintiff,

vs.

MILTON SPERLING, HARRY M. WARNER,
JACK L. WARNER, UNITED STATES
PICTURES, INC., and WARNER BROS.
PICTURES, INC., Defendants.

JUDGMENT OF DISMISSAL

The above-entitled action came on regularly for trial the 7th day of April, 1953, in the above-entitled Court, Hon. William C. Mathes, District Judge presiding. Plaintiff was represented by Messrs. Moss, Lyon & Dunn and Herman H. Levy, Esq., defendants Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc. were represented by Messrs. Freston & Files, Eugene D. Williams, Esq. and Joseph D. Karp, Esq., defendants Milton Sperling and United States Pictures, Inc. were represented by Oliver B. Schwab, Esq.

The third cause of action set forth in the complaint was dismissed by the Court without prejudice prior to trial and no findings were made herein with reference thereto.

It appearing to the Court that the issues as to whether this Court has jurisdiction of the subject matter of the action and as to whether the action

is barred by the applicable statute of [157] limitations are presented by the pleadings and that said issues should be disposed of in advance of a trial of the other issues in the case, it was ordered that the two issues, (1) as to whether this Court has jurisdiction of the subject matter of the action and (2) as to whether the causes of action are barred by the provisions of the applicable statute of limitations should be tried in advance of the trial of the other issues, and it was ordered that both parties present evidence only as to those two issues.

Thereupon, evidence on behalf of plaintiff and defendants was offered and received, the cause argued and submitted to the Court upon the two above stated issues only. The Court having duly considered the evidence and the law, and being fully advised in the premises, and having heretofore signed and filed its written Findings of Fact and Conclusions of Law, wherein and whereby judgment was ordered that said action be dismissed;

Now, Therefore, It Is Ordered, Adjudged and Decreed that the above-entitled action be and the

without costs to any party [Mathes, J.]
same hereby is dismissed, [^] ~~and that the defendants~~
~~do and recover of and from the plaintiff their costs~~
~~hereby taxed in the sum of \$.....~~

constitute [Mathes, J.]

This judgment of dismissal does not [^] ~~operate as~~
an adjudication upon the merits and is without prejudice or res judicata effect.

January 21, 1954.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES;
EUGENE D. WILLIAMS and
JOSEPH D. KARP,

/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner. [158]

Affidavit of Service by Mail attached. [160]

[Endorsed]: Lodged December 24, 1953.

[Endorsed]: Filed January 21, 1954.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR LEAVE TO
AMEND COMPLAINT TO CONFORM TO
EVIDENCE—MEMORANDUM OF POINTS
AND AUTHORITIES

To the Defendants, Harry M. Warner, Jack L. Warner and Warner Bros. Pictures, Inc., and to Their Attorneys, Freston & Files and Eugene D. Williams; to the Defendants, Milton Sperling and United States Pictures, Inc., and to Their Attorney, Oliver B. Schwab:

You and Each of You Will Please Take Notice that on Monday, February 15, 1954, at 10:00 a.m. of said day or as soon thereafter as counsel can be heard at the courtroom of the Honorable William Mathes located in the Federal Courthouse, Los Angeles, California, plaintiff Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, deceased, will move the court for leave to file an amended and supplemental complaint in the

above entitled action, to conform to the evidence at the [161] trial thereof as set forth in the proposed Amended and Supplemental Complaint, a copy of which is attached hereto and made a part hereof.

Said motion will be made upon the grounds that an amended and supplemental complaint is necessary to conform the pleadings to the evidence adduced at the trial of the action of the issues of jurisdiction and the Statute of Limitations.

Said motion will be based upon this notice, memorandum of points and authorities, the proposed amended and supplemental complaint, a copy of which is served herewith, and the pleadings, records, files and minutes of the court in the within action.

Dated: February 5, 1954.

MOSS, LYON & DUNN and
HERMAN H. LEVY,
/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.

Memorandum of Points and Authorities.

I.

Amendments of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time and such motion may be made after judgment.

Rule 15 (a) Federal Rules of Civil Procedure.
Simms vs. Andrews, 118 F.2d 803.

Sears Roebuck & Co. vs. Marhenke, 121 F.2d 598.

II.

The court may permit a party to serve a supplemental pleading setting forth transactions or occurrences or events which have happened since the date of the pleading sought to be supplemented.

Rule 15 (d) Federal Rules of Civil Procedure.

III.

Leave to amend pleadings should be freely and liberally granted.

Rule 15 (a) Federal Rules of Civil Procedure.

Snyder vs. Dravo Corp., 6 F. R. D. 546.

Respectfully submitted,

MOSS, LYON & DUNN and

HERMAN H. LEVY,

/s/ By HERMAN H. LEVY,

Attorneys for Plaintiff. [163]

Affidavit of Service by Mail attached. [164]

[Endorsed]: Filed February 5, 1954.

[Title of District Court and Cause.]

AMENDED AND SUPPLEMENTAL COMPLAINT (AFTER TRIAL TO CONFORM TO PROOF) AND FOR ACCOUNTING AND DAMAGES

Plaintiff Edward S. Birn having sued herein derivatively on behalf and for the benefit of defend-

ant Warner Bros. Pictures, Inc., and the stockholders thereof; and upon his death the Special Administrator of his estate in California having, by order of this court, been duly substituted as party plaintiff; and plaintiff having first obtained leave of the court so to do, now files this amended and supplemental complaint after trial to conform to proof, as follows: (All of the allegations below being upon information and belief except allegations "1" to "4", inclusive, and allegation "24", which are alleged as of plaintiff's knowledge.

For a First Cause of Action Against All Defendants.

1. Jurisdiction herein is founded on diversity of citizenship and amount. This action is not a collusive one to confer on [165] this court jurisdiction of an action over which it would not otherwise have jurisdiction.

2. The matter in controversy exceeds, exclusive of interest and costs, the sum of \$3,000.

3. Plaintiff's decedent was a citizen of the State of New York, and the estate of said decedent is in the course of probate in said state.

4. Plaintiff's decedent was the owner of 400 shares of capital stock of defendant Warner Bros. Pictures, Inc. throughout the time that the transactions herein complained of occurred. He has owned said stock since August 21, 1944.

5. Defendants Warner Bros. Pictures, Inc., (hereinafter referred to as Warner Bros.) and United States Pictures, Inc., (hereinafter referred

to as United) are corporations incorporated under the laws of the State of Delaware, engaged in the motion picture business and said corporations do business and maintain offices in the County of Los Angeles and State of California.

6. The defendants Milton Sperling, Harry M. Warner and Jack L. Warner are citizens of the State of California.

7. During the time that the transactions hereinbelow complained of occurred, the defendants, Harry M. Warner and Jack L. Warner, were officers of Warner Bros. Harry M. Warner was President, and Jack L. Warner a Vice-president.

8. The following persons were directors of Warner Bros. during the periods stated after their respective names

Harry M. Warner, 1923 to date; Jack L. Warner, 1923 to date; Albert Warner, 1923 to date; Wadill Catchings, 1925 to date; Morris Wolf, 1926 to date; Stanleigh P. Friedman, 1931 to date; Charles S. Guggenheimer, 1932 to date; [166] Samuel Carlisle, 1934 to date; Robert W. Perkins, 1936 to date; Samuel Schneider, 1944 to date; Joseph Bernhard, 1936 to September 10, 1945; John E. Bierwirth, November, 1945 to date.

9. Harry M. Warner, Jack L. Warner and Albert Warner are brothers and Milton Sperling was at all times herein mentioned and is the son-in-law of Harry M. Warner.

10. At all times herein mentioned, Warner Bros. was a publicly owned corporation. Harry M. Warner and Jack L. Warner, together with their

brother Albert Warner owned a large block of its outstanding stock, to-wit: approximately 16%, and did actively direct its supervision, policies, actions and business, including the acts hereinafter alleged in this complaint. The public, namely, some 30,000 shareholders located in the various states of the United States, and in countries all over the world, owned the remainder of the company's stock.

11. Since 1945, Warner Bros. has participated with United in a series of nine transactions which involved the investment by Warner Bros. of millions of dollars in ventures in motion picture production-distribution, the sharing of profits in said ventures, accounting to each other for losses and the payment of large sums of money to said Sperling and Bernhard, under a contract and a series of five successive amendments thereto.

12. The contract is dated September 28, 1945. It was approved by the Warner Board of Directors on said day. Plaintiff claims and alleges that Harry Warner, as President of Warner Bros., participated in negotiations which preceded the drawing and approval thereof. It is hereinafter referred to as the "basic contract".

13. The first three amendments to the basic contract were entered into prior to the commencement of this suit, to-wit: [167] Amendment dated November 2, 1945; amendment dated May 20, 1946, and amendment dated December 6, 1947. The first two of said amendments were approved by the Warner Board of Directors. The third amendment was neither submitted to nor approved by the War-

ner Board before the suit was commenced. The fourth and fifth amendments to the basic contract were entered into during the pendency of the suit. They are dated July 21, 1950, and August 12, 1952, and were approved by the Warner Board of Directors. Plaintiff claims and alleges that Harry Warner, as President of Warner Bros. participated in the negotiation of all said amendments; and when the third, fourth and fifth amendments were executed, Harry Warner and his daughter Betty Sperling had a financial interest in United.

14. Plaintiff attaches photostat copies of the basic contract and all said amendments, refers to them and makes them a part of this amended and supplemental complaint as though fully set forth at length.

15. On or about August 6, 1945, United was caused to be organized for the purpose of engaging with Warner Bros. in said ventures. United's capital stock was issued to Sperling and to said Bernhard, who was then a Warner director, and a resident of the State of New York, and who subsequently resigned from the Warner Board and severed his connection with Warner Bros., to-wit: his employment contract with Warner Bros. was terminated and in connection with such termination, Warner Bros. awarded him \$78,000 "severance pay", although his employment contract contained no provision entitling Bernhard to severance pay. Since September 1946, Sperling has been United's only stockholder, with the exception of 62 shares which, prior to the commencement of this

action, he assigned to Title Insurance and Trust Company of Los Angeles, California, a California corporation, to be held in trust for the benefit of his minor children, who are Harry Warner's grandchildren. [168]

16. Plaintiff claims and alleges that United was organized as aforesaid in order that through it, Sperling might utilize Warner Bros. funds, its facilities, assets and business opportunities in a manner unfair to Warner, unwarrantedly favorable to United and Sperling; and, to further and enrich Sperling's private interests at Warner Bros. expense.

Plaintiff claims and alleges that the basic contract and said amendments are unfair to Warner Bros. and unwarrantedly favorable to United and Sperling. That all said agreements have been performed in a manner unwarrantedly favorable to United and Sperling and unfair to Warner Bros. and that the aforementioned \$78,000 award to Bernhard was unlawful.

17. Plaintiff claims and alleges that at the time of the making of the basic contract, it was intended by defendants that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of said six motion pictures by means of the borrowing privileges set forth in Paragraph 31 of the basic contract.

18. That in furtherance of the intention as set forth in the preceding paragraph, and pursuant to the provisions of Paragraph 31 of the basic con-

tract, the defendants caused an agreement to be entered into between Warner Bros. and United and The New York Trust Company (the latter being a New York banking corporation), which provides for the loan by The New York Trust Company to United of the latter's share of the cost of production of pictures, and under said agreement, United pledged and caused to be pledged to said bank, three pictures and the net income therefrom, as security for the repayment of loans to United on said pictures;

19. Plaintiff claims and alleges that said loan agreement was effectuated through the use of the valuable credit and banking facilities and connections of Warner Bros. in that said [169] John E. Bierwirth was the President of The New York Trust Company and his influence was used by Warner Bros. and Joseph Bernhard to effect said loan agreement, and further, in that Warner Bros. was and is a valued customer of The New York Trust Company and its patronage was favorably sought for various reasons including the fact that Warner Bros. was then indebted to a syndicate of banks, including The New York Trust Company, to the extent of several million dollars.

20. That in pursuance of all the agreements hereinbefore referred to, and during the period commencing in or about January, 1946, to approximately September, 1947, United has borrowed large sums from The New York Trust Company and the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being

used by United, and the said agreements have been in part performed and motion pictures were and are being produced and distributed under said agreements and said agreements remain in part unperformed.

21. That in connection with the performances of said agreements, United has not advanced any of its private funds or capital and has contributed to the costs of production of three of said pictures solely out of loans from The New York Trust Company, and that all other capital required for the production of said three pictures and six additional pictures has been contributed by Warner Bros.

22. Plaintiff claims and alleges that defendants have designed and contrived to cause said agreements to be performed in a manner unfair to Warner Bros. and to benefit and to further the interests of United and Sperling at the expense of and detriment to Warner Bros. That said agreements have not been made, performed and administered as "arms length" transactions between Warner Bros. and United.

23. That in or about or prior to the summer of 1945, the [170] individual defendants did illegally, wrongfully and in bad faith, conspire and act together and did conspire and still continue to conspire to waste, mismanage, divert and misappropriate the assets and business opportunities of Warner Bros. in favor of, and to further and enrich the private interests of defendant Sperling and United at the expense of Warner Bros. and regardless of

the consequences to Warner Bros., and each of the different things and acts done and being done by said individual defendants, and by the corporate defendants through their directors and officers, as herein alleged, were, among others, and continue to be, all steps in said conspiracy and were and are being committed pursuant thereto, and in furtherance of said objects. That in performing such acts and doing such things, defendants acted and continue to act unfairly to Warner Bros, and for the benefit of and advantage to United and Sperling; and the defendants Harry Warner and Jack Warner were and continue to be unfair and disloyal to their trust as directors and executive officers of Warner Bros.

Plaintiff claims and alleges that defendants Harry and Jack Warner, together with their brother Albert Warner, did actually select, dominate and control the other directors and officers of Warner Bros.

24. That plaintiff's decedent did not discover the facts herein set forth until October of 1948, and plaintiff's decedent had no notice or information of circumstances which would put him on inquiry regarding such facts until October of 1948.

25. That by reason of the premises, Warner Bros. has suffered and still suffers improper and illegal waste, mismanagement, misappropriation and diversion of its valuable assets, credits, facilities and business opportunities all to its loss and to the improper and personal profit and benefit of United and Sperling, in that:

(a) Warner Bros. has been and is being subjected to [171] undertaking unfair, extraordinary and unwarranted risks of capital and other loss and injury in said ventures;

(b) Warner Bros. vast organization, its capital, its picture making facilities, described in the basic agreement, have been and are being made available to and utilized by, United, and through it, Sperling, without adequate, reasonable, legal considerations, return or payment to Warner Bros.; and under terms and conditions which fail to adequately safeguard Warner Bros. against advantage being unduly and improperly taken of Warner Bros. by United and Sperling, in the course of their participation in these ventures;

(c) The distribution fees and percentages of profits provided to be paid to Warner Bros. are unreasonably low and unfair to Warner Bros.;

(d) The last three amendments to the basic contract were calculated to and did compound and increase the unfairness to Warner Bros. of the terms of the basic contract and did, at Warner Bros. risk and expense, provide additional unfair advantage to United and corresponding disadvantage to Warner Bros.; and, said amendments were calculated to and did postpone and they continue to postpone unreasonably and indefinitely United's obligation to pay Warner Bros. approximately \$850,000, namely, the loss suffered by Warner Bros. in the third of such ventures;

(e) The subordination and use of the capital assets and facilities of Warner Bros. in favor of,

and as collateral security for, the aforesaid loans to [172] United, constitutes an improper or illegal use of property of Warner Bros. for which the latter receives in return no legal, adequate or fair consideration;

(f) The subordination and use of the capital, assets and facilities of Warner Bros. in favor of, and as collateral security for, the aforesaid loans to United, constituted a breach of the existing written agreement between Warner Bros. and a syndicate of banks under which Warner Bros. is the recipient of large business loans totalling several millions of dollars, and the said last named written agreement with said banks prohibits such use of the capital and assets of Warner Bros., and thereby Warner Bros. has been endangering said loans and injuring its credits.

(g) In the performance of the basic contract and the amendments, United received unfair and unwarranted advantages at Warner Bros. expense; and United was furthermore permitted to and it did, violate the terms of the said agreements and thereby gained unfair and unwarranted advantage, at Warner Bros. expense and to its detriment.

26. That by reason of the premises, the defendant United and its assets, and the profits and benefits derived by it from Warner Bros. under the above mentioned agreements, are substantially based upon, result from, and stand in the place of, the assets and business opportunities wrongfully diverted from Warner Bros. to United, and hence the capital stock of United, and all of its said assets

belong in equity and good conscience to Warner Bros.

27. Demand upon the directors of Warner Bros. to institute this action would have been futile and plaintiff had made no such [173] demand because all or a majority of the present Board of Directors and officers of said corporation wrongfully participated in the acts and grievances herein complained of and said Board of Directors is controlled by the active wrongdoers herein, and since those to whom application would have to be made to institute this suit are the same persons who wrongfully caused or permitted the grievances herein complained of, such persons would refuse to bring suit against themselves and in fact would be disqualified from faithfully doing so.

28. Plaintiff's decedent has made no demand upon the stockholders of Warner Bros. because under the laws of Delaware the management of Warner Bros. is directed by its Board of Directors and the stockholders cannot bring suit for Warner Bros., nor require the Board of Directors to bring such suit; and further because the defendants Jack L. Warner and Harry M. Warner and their brother Albert Warner hold upwards of sixteen per cent (16%) of the total issued stock of Warner Bros. and the balance of such stock is held by upwards of 30,000 stockholders widely scattered over the United States and foreign countries all over the world making it virtually impossible and impractical to obtain concerted action by the stockholders,

and would entail a prohibitive cost and expense to the plaintiff.

29. Plaintiff has no adequate remedy at law and he and stockholders similarly situated and Warner Bros. will suffer irreparable damage unless the relief requested herein be granted.

For a Second Cause of Action Against All Defendants Except United and Sperling:

30. Repeats and realleges each and every allegation contained in paragraphs above numbered "1" to "29" (except "23"), inclusive, with the same force and effect as though herein alleged.

31. That by reason of the acts committed by these defendants as herein alleged, the defendants Harry and Jack Warner, [174] while acting in their fiduciary capacities and while charged with their fiduciary duties as directors, have violated said duties and have failed and neglected to providently and prudently perform their said duties and have been guilty of culpable misfeasance, nonfeasance, mismanagement, negligence, waste and dissipation of assets of Warner Bros., all of which has been to the large pecuniary loss of Warner Bros.

Wherefore, plaintiff demands judgment as follows:

- (1) That the defendants account to Warner Bros. for all losses and damages suffered by it and for all profits and benefits received by said defendants, and that defendants make restitution accordingly.
- (2) That a trust be impressed upon the capital

stock and assets of United in favor of Warner Bros.

(3) That the agreement between Warner Bros. and United to the extent that the same is unexecuted and to the extent that it is practicable to do so, should be cancelled and terminated.

(4) That defendants Harry M. Warner and Jack L. Warner make whole Warner Bros. Pictures, Inc. for all damages that it has suffered because of such defendants' successive breaches of their fiduciary duty to Warner Bros. Pictures, Inc., or arising out of the same, and because of their illegal and wrongful acts herein alleged.

(5) That plaintiff be allowed the costs, disbursements and expenses of this action, including reasonable counsel and accountants fees.

(6) That such other and further relief be granted as shall be equitable in the premises.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff. [175]

Duly Verified. [176]

Affidavit of Service by Mail attached. [182]

[Endorsed]: Lodged February 5, 1954.

[Title of District Court and Cause.]

ORDER DENYING MOTION FOR
LEAVE TO AMEND

The motion of plaintiff for an order granting him leave to file an amended and supplemental complaint came on regularly to be heard the 15th day of February, 1954, before Hon. William C. Mathes, District Judge, and was duly made, presented and argued.

Upon due consideration thereof, it is now ordered that said motion be and the same hereby is denied.

Done in Open Court February 15, 1954.

/s/ WM. C. MATHES,
District Judge.

Submitted by:

FRESTON & FILES and
EUGENE D. WILLIAMS,

/s/ By EUGENE D. WILLIAMS,
Attorneys for Defendants Warner. [183]

Approved As to Form:

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY,
Attorneys for Plaintiff.
OLIVER B. SCHWAB, ESQ.,

/s/ By OLIVER B. SCHWAB,
Attorney for Defendants Sperling and
United States Pictures, Inc. [184]

[Endorsed]: Filed March 31, 1954.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that plaintiff Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, Deceased, hereby appeals to the Court of Appeals for the Ninth Circuit from the Judgment of Dismissal entered January 21, 1954.

Dated: February 16, 1954.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By GEORGE C. LYON,
Attorneys for Plaintiff. [185]

Affidavit of Service by Mail attached. [186]

[Endorsed]: Filed February 17, 1954.

[Title of District Court and Cause.]

STIPULATION

The plaintiff having moved this Court for an order granting him leave to file an amended and supplemental complaint to conform to the proof, to which were to be attached the following contracts between the corporate defendants to wit: Contract dated September 28, 1945; Amendment dated November 2, 1945; Amendment dated May 20, 1946; Amendment dated December 6, 1947; Amendment dated July 21, 1950; and Amendment dated August 12, 1953, and

The Motion having duly come on to be heard in

open Court on the 15th day of February, 1954, before the Honorable William C. Mathes, District Judge, and

The Court having heard argument thereon by the undersigned, in the course of which the undersigned attorneys for the defendant agreed to enter into the following stipulation, [192]

It Is Stipulated As Follows:

The undersigned attorneys for the defendants agree (1) that each and all of plaintiff's claims which are set forth in the said proposed amended and supplemental complaint have been duly brought to the notice and attention of this court during and prior to the trial heretofore had herein; (2) in the event of an appeal from the judgment heretofore entered on January 21, 1954, the undersigned attorneys for plaintiffs will not urge, in the Appellate Courts, that the subject matter which is contained in said proposed amended and supplemental complaint, or any part thereof, is being raised by plaintiff for the first time on appeal.

Dated: February 15, 1954.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY,
Attorney for plaintiff.

FRESTON & FILES and
EUGENE D. WILLIAMS,

/s/ By EUGENE D. WILLIAMS,
Attorneys for defendants, Harry M. Warner, Jack
L. Warner and Warner Bros. Pictures, Inc.

/s/ OLIVER B. SCHWAB,

Attorney for Defendants Milton Sperling and
United States Pictures, Inc. [193]

[Endorsed]: Filed March 31, 1954.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 196, inclusive, contain the original Complaint; Answer of Defendants Sperling et al; Answer of Defendants Harry M. Warner et al; Stipulation of Facts; Motion for Leave to File Amended and Supplemental Complaint; Objections to Motion for Leave to File Amended and Supplemental Complaint; Order Denying Motion for Leave to File Amended and Supplemental Complaint; Stipulation Concerning Other Stockholders' Cases; Memorandum of Decision; Objections to Findings of Fact and Conclusions of Law; Findings of Fact and Conclusions of Law; Judgment of Dismissal; Motion for Leave to Amend Complaint to Conform to Evidence, etc.; Proposed Amended and Supplemental Complaint to Conform to Proof, etc.; Order Denying Motion for Leave to Amend; Notice of Appeal; Stipulation and Order Extending Time to Docket Appeal; Designation of Record on Appeal; Stipulation; Stipula-

tion re Designation of Record and a full, true and correct copy of Minutes of the Court for April 12, 1954 which, together with the original exhibits and copy of reporter's transcript of proceedings on trial, transmitted herewith, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing and certifying the foregoing record amount to \$2.00 which sum has been paid to me by appellant.

Witness my hand and the seal of said District Court this 27th day of April, A.D. 1954.

[Seal]

EDMUND L. SMITH,
Clerk

/s/ By THEODORE HOCKE,
Chief Deputy.

In the United States District Court, Southern District of California, Central Division

No. 9005-WM-Civil

Edward S. Birn, Plaintiff, vs. Milton Sperling, Harry M. Warner, Jack, L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Defendants. (now entitled): Charles B. Smith as Special Administrator of the Estate of Edward S. Birn, Deceased, Plaintiff, vs. Milton Sperling, et al., Defendants.

REPORTER'S TRANSCRIPT OF
PROCEEDINGS

Los Angeles, Calif., Tuesday, April 7, 1953

Honorable William C. Mathes, Judge Presiding.

Appearances: For the Plaintiff: Messrs. Moss, Lyon & Dunn and Herman H. Levy, Esq. For the Defendants Warner: Messrs. Freston & Files, Eugene D. Williams, Esq., and J. D. Karp, Esq. For the Defendants Milton Sperling and United States Pictures, Inc.: Oliver B. Schwab, Esq. [1*]

Mr. Williams: If your Honor please, before we do start, may I have the privilege of asking to have associated as counsel for the Warner defendants Mr. Joseph D. Karp, of New York City. Mr. Karp is admitted to practice in all of the courts of the State of New York and in the United States [3]

* Page numbers appearing at top of page of original Reporter's Transcript of Record.

District Courts for the Southern and Eastern Districts of New York, and also in the Court of Appeals for the Second Circuit.

The Court: You move his admission?

Mr. Williams: I move his admission for this case. I, of course, vouch for his integrity and ability.

The Court: The motion will be granted. [4]

* * * * *

Mr. Levy: I proceed now, sir, to reading a list of interrogatories which is marked Exhibit 105, the answers to which are contained in Exhibit 105-A for identification. Both exhibits are now in for identification only.

“To the defendant United States Pictures, Inc.:

“Pursuant to the order of court dated April 11, 1949, authorizing plaintiff to serve and file additional interrogatories, please furnish, under oath, written answers to the following interrogatories:

* * * * * [271]

The Court: These are matters that deal with accounting?

Mr. Williams: Yes, your Honor. [272]

* * * * *

The Court: Do you have to read it into the record at this juncture? If you wish it in the record at this point, wouldn't it be just as well to have the reporters copy them into the record, or is it something that you wish me to hear at this point? [273]

Mr. Levy: No, I do not think that a reading of it will have any greater effect on your Honor at this point, would give your Honor a greater understanding of the relevancy and the meaning of these

figures if read rather than heard. But in view of the fact that my brother Williams objects to the introduction of the physical document itself, I must read the figures into the record so that the record will contain the answer to the interrogatory.

The Court: Do you wish the document in the record at this point because of the orderly presentation of the evidence? As far as I am concerned, it would not help me to have you read these figures to me.

Mr. Levy: I agree, your Honor.

The Court: It may be helpful, and it has been up to this point, to have you present the matter in a certain chronological fashion. Otherwise I would urge you to offer it all into evidence and permit me to read it, instead of going through this much slower process of listening to it.

Mr. Levy: Yes, your Honor.

The Court: We are coming, gentlemen, I think, to the point where it will be desirable to revert to my former practice, and that is to receive all these matters into evidence, and of course the record on appeal may be limited to avoid duplications and unnecessary matters. [274]

* * * * *

The Court: Here is the way I view it, gentlemen: This is the plaintiff's case. On the plaintiff's case he may, within the limitations of the rules, make his record as he thinks best. The same with the defendants when the time comes to introduce the defendants' evidence.

I will reverse my rulings as to Exhibits 103,

103-A, 104, 104-A, and 104-B and receive those documents into evidence. [275]

* * * * *

(The documents previously marked Plaintiff's Exhibits 103, 103-A, 104, 104-A and 104-B, were received in evidence.) [276]

* * * * *

(The documents previously marked Plaintiff's Exhibits 105 and 105-A were received in evidence.) [279]

* * * * *

The Court: You may proceed in the case on trial.

Mr. Levy: Referring, if the court please, to Exhibits 105 and 105-A from which I read just before the adjournment, I shall read, with the court's permission, only two or three of the interrogatories contained in that exhibit which set forth a fact or facts without long lists of figures, and rely upon the factual content of these exhibits, rely for the actual content of these exhibits on the physical documents themselves, which I shall offer into evidence.

The Court: I suggest you first offer into evidence the documents themselves.

Mr. Levy: Yes, your Honor.

Mr. Williams: I understand they have already been received.

* * * * *

Mr. Levy: This Exhibit 105, incidentally, is dated April . . . , as I have it here, 1949. But, as I have read before, it was served pursuant to an order of this court [280] dated April 11th and the an-

swers to the interrogatories are dated May 18, 1949 and verified by J. C. Yoss, Treasurer, United States Pictures. [281]

* * * * *

Mr. Levy: Next are 106 and 106-A.

Exhibit 106, may it please the court, is a list of interrogatories addressed to the defendant United States Pictures, pursuant to an order of this court dated February 27, 1950. It is dated—and I refer now to Exhibit 106—March 24, 1950.

The answers thereto are contained in Exhibit 106-A. That exhibit contains a notation, namely, "Submitted March 25, 1950."

* * * * *

The Court: Do you offer them in evidence? [286]

Mr. Levy: I do offer them in evidence at this time.

Mr. Williams: May the record show that the date of the verification of Exhibit 106 is July 20, 1950?

The Court: Exhibits 106 and 106-A for identification are received in evidence.

(Plaintiff's Exhibits 106 and 106-A for identification were thereupon received in evidence.)

* * * * * [287]

I proceed now, your Honor, to Exhibit 107, marked for identification up to the present time. That exhibit contains both the interrogatories and the answers thereto. I now offer Exhibit 107 for identification into evidence.

The Court: Is there objection? [299]

* * * * *

(The document heretofore marked Plaintiff's Exhibit 107, was received in evidence.) [300]

* * * * *

Attached to this exhibit are schedules, if the court please, commencing with Schedule A, the pages of which are unnumbered, however, and proceeding down to and including Schedule H which, incidentally, is the August 12, 1952 amendment, namely, the latest amendment to the master contract.

That, if the court pleases, is the substance of the Exhibit No. 107 in evidence.

The Court: I take it the schedules attached to Exhibit 107 are understood by the parties to be in evidence.

Mr. Williams: Yes, your Honor. [423]

The Court: As part of the exhibit.

Mr. Levy: Yes, your Honor.

The Court: And that they should be given various identifying letters. Schedules A to H, inclusive, shall have in this record here the same identifying letter under the Exhibit 107 as those exhibits are given in Exhibit 107 itself. In other words, Schedule A will be in this record Exhibit 107, Schedule A of Exhibit 107.

Mr. Levy: Yes, your Honor, and so referred to throughout the trial as Schedule A of Exhibit 107 in evidence?

The Court: Yes, for the purposes of identifying in this record here as distinguished from the identification in the exhibit itself.

Mr. Levy: Yes, your Honor.

(The schedules were marked Schedules A to H, inclusive, to Exhibit 107 in evidence.)

Mr. Levy: I proceed to the reading of Exhibit 108—I withdraw that. May I at this time offer Exhibits 108 and 108-A into evidence. [424]

* * * * *

The Court: In the case on trial you may proceed. Have Exhibits 108 and 108-A been offered?

Mr. Levy: My recollection is that they have, your Honor.

* * * * *

(The documents were thereupon marked Plaintiff's Exhibits 108 and 108-A and received in evidence.)

Gentlemen, if there is no objection, when ever an order is made receiving in evidence any deposition, interrogatories or answers thereto, requests for admissions or answers or responses thereto, or any other exhibit to which there is attached one or more charts, schedules or other writings or exhibits, all such attachments shall be deemed likewise received in evidence, and shall be identified in the records of this trial as a subdivision of the exhibit of which a part, and shall be sub-numbered or sub-lettered as the case may be, or otherwise given the same identification as in the exhibit of which a part.

Is that agreeable?

Mr. Levy: It is agreeable.

The Court: So ordered. You may proceed, Mr. Levy. [426]

* * * * *

The Court: Were the requests for admissions directed to all?

Mr. Levy: Yes, sir, your Honor, to Harry M. Warner, Jack L. Warner, and Warner Bros. Pictures, Inc.

The Court: Is it stipulated that the admissions are the admissions of all the defendants to whom the requests were directed?

Mr. Williams: Yes, if your Honor please. [427]
* * * * *

"Request No. 4. That at all times mentioned in Plaintiff's complaint, Defendants Harry M. Warner and Jack L. Warner together with their brother Albert Warner did actively direct the supervision, policies, actions and business of Warner Bros. Pictures, Inc."

The answer thereto is: "Yes."

"Request No. 5. That at all times mentioned in Plaintiff's complaint, the defendants Harry M. Warner and Jack L. Warner together with their brother Albert Warner exercised the selection of directors and officers of Warner Bros. Pictures, Inc."

The answer is: "No." [430]

* * * * *

Request No. 8:

"That there are no other independent producers contracts entered into by Warner Bros. Pictures, Inc. with the same terms and conditions as the contract with United States Pictures, Inc."

The answer is: "Yes."

Request No. 9:

"That at the time of the making of the agreement of September 28, 1945, between Warner Bros. and United States Pictures, Inc., it was intended by the parties thereto that United was not to advance any of its private funds or capital in the performance of said agreement, but was to meet its share of the cost of production of the motion pictures to be produced thereunder by means of the borrowing privileges set forth in said agreement."

The answer thereto is: "No." [432]

Request No. 10:

"That the loan agreement dated October 31, 1945, between The New York Trust Company, United States Pictures, Inc., and Warner Bros. Pictures, Inc. was effectuated through the credit and banking facilities and connections of Warner Bros."

The answer thereto is: "No."

Request No. 11:

"That pursuant to the agreements between United and Warner Bros., and The New York Trust Company and United and Warner Bros., and during the period commencing in or about November, 1945, to date, the funds, credits, facilities, assets and business opportunities of Warner Bros. were and still are being used by United."

The answer thereto is:

"No; except as the funds, credits, and facilities of Warner Bros. are provided by the contract of November, 1945, between United States and Warner's, to be so used, and except as provided by all amendments and supplements to said contract."

Request No. 12——

Mr. Williams: Incidentally, before we leave that, we were actually referring to the contract of September 28, 1945. [433] Don't you think it would be better if we agreed to stipulate that instead of "November, 1945," it should be "September 28, 1945," in that answer?

Mr. Levy: Your statement to the effect that that is what you intended is perfectly satisfactory to me, and I will so stipulate, your Honor.

The word "November" may be by Mr. Williams changed in the original and in its place there may be substituted the words "September 28, 1945."

Request No. 12:

"That during the period January 1, 1945, to November 23, 1950, Warner Bros. has not asked for, nor has there been given, the written consent of the holders of 75 per cent in amount of the outstanding notes referred to in paragraph 10 of the Stipulation of Facts on file in the within action permitting any lien or incumbrances to exist on any of the following assets of Warner Bros. or its subsidiaries:

"(a) Motion pictures, photoplays produced in the United States or Canada.

"(b) Accounts or notes receivable or moneys due or to become due under contracts."

The answer thereto is: "Yes." * * * * * [434]

I proceed now, if the court please, to Exhibit 109 in evidence, and I at this time offer Exhibit 109 and 109-A in evidence.

The Court: They may be received in evidence.

(Plaintiff's Exhibits 109 and 109-A for identification were thereupon received into evidence.)

Mr. Levy: 109 contains a series of requests for admissions addressed to the defendants Milton Sperling and United States Pictures, as follows:

Before I read them, may I state that Exhibit 109, namely, the requests, is dated July 20, 1951, and the answers thereto that are contained in Exhibit 109-A are dated August 2, 1951, and were verified on the same day, namely, August 2, 1951?

* * * * * [435]

Request No. 2:

"That at the time of making the agreement dated September 28, 1945, between Warner Bros. Pictures, Inc. and United States Pictures, Inc. it was intended by the parties thereto that United was not to advance any of its private funds or capital in the performance of said agreement and that United was to meet its share of the cost of production of the motion pictures to be produced thereunder by means of the borrowing privileges set forth in said agreement."

The answer is: "This is denied."

Request No. 3:

"That pursuant to said agreement dated September 28, 1945, and during the period commencing in or about November, 1945, to date the funds, credits, facilities, assets, and business opportunities of Warner Bros. were and still are being used by United States Pictures, Inc."

The answer is as follows:

"Pursuant to the agreement dated September 28, 1945, as amended and supplemented, U. S. Pictures has received advances from Warner Bros. toward the cost of production of its pictures, in accordance with [436] provisions of said agreement as amended and supplemented, and has to that extent used Warner Bros. funds and credits. Also, pursuant to said agreement dated September 28, 1945, as amended and supplemented, United States Pictures has utilized the studio and facilities of Warner Bros, in the making of its pictures and to that extent has used the facilities and assets of Warner Bros. Except so as admitted, No. 3 is denied." [437]

* * * * *

Request No. 6:

"That the contract dated September 28, 1945, between Warner Bros. and United States Pictures, Inc. was negotiated by defendant Milton Sperling and defendant Harry M. Warner."

The answer is as follows:

"Milton Sperling and Harry M. Warner each participated to some extent in the negotiations for the contract dated September 28, 1945, but other persons had an important part in the negotiations."

* * * * *

I proceed now, if the court please, to a reading [439] of Exhibit 110, and before doing so I offer it in evidence.

The Court: Received in evidence.

(Plaintiff's Exhibit No. 110 for identification was thereupon received in evidence.) [440]

* * * * *

Mr. Levy: Very well. These are requests directed to defendants Harry M. Warner and Jack L. Warner, and each of them, and the answers, as I believe I indicated a moment ago, sir, are contained in the same exhibit, the answer following the request in each case.

“Request No. 1. Warner’s business is producing motion pictures.

A. True in part; but in addition to producing motion pictures, Warner through its subsidiaries is [441] also engaged in the business of distributing motion pictures and, until March 2, 1953 was in the business of exhibiting motion pictures in hundreds of motion picture theatres operated by its subsidiaries. Warner derives no profit as such from its production of motion pictures; its profits are derived and were derived from exhibition and distribution of motion pictures. For example, in the fiscal year 1944-1945, Warner’s net profit from distribution was about \$4,590,000, and from exhibition about \$5,310,000; in the fiscal year 1947-1948 distribution resulted in a net loss of about \$246,000, while exhibition resulted in a profit of about \$12,000.”

Mr. Williams: “\$12,000,000.”

Mr. Levy: “\$12,000,000.”

“Request No. 2. A series of buildings and other structures located in Burbank acquired and maintained at considerable cost, house Warner’s many and varied picture making facilities.

A. True.

Request No. 3: A number of departments, headed

by executives employ the varied skills of men and women trained in the arts and many sciences; business administrators, accountants, lawyers; and the labor, [442] skilled and unskilled of a large personnel.

A. True.

Request No. 4: The total cost of Warner's production program for the fiscal year 1944 to 1945 as reported by Price, Waterhouse & Co. was approximately \$31,000,000."

Mr. Williams: "\$31,300,000."

Mr. Levy: "\$31,300,000." Thank you.

The answer: "True; said costs being about \$22,000,000 direct and about \$9,300,000 overhead.

Request No. 5: Warner's product, namely prints of pictures put up in cans, is supplied to motion picture exhibitors throughout the world on a rental basis.

A. True in part; and to this extent, namely, that Warner produced positive prints of motion pictures which are supplied through motion picture exchanges in the United States and foreign countries to motion picture exhibitors on either a percentage or a flat rate license basis, and to theatres operated by Warner and its wholly owned subsidiaries.

Request No. 6. A subsidiary company and affiliated companies handle the distribution and exploitation of Warner's pictures, the booking and contracting for the rentals, the publicizing, [443] advertising, the delivery of the product to exhibitors and the collection of the income therefrom.

A. True in part; but it should be added that there are several subsidiary companies and that in addition to those referred to in the request for admissions, there are theatre companies owned and operated by Warner. [444]

* * * * *

Request No. 9. Warner's system of bookkeeping is so designed as to enable Warner to determine, among other things, the total production cost to Warner of each picture produced.

A. True.

Request No. 10. The said system separates 'production costs' into two categories; 'direct' costs and 'overhead' costs.

A. True.

Request No. 11. During the fiscal year, 1944-1945, as reported by Price, Waterhouse & Co. some \$9,300,000.00 or approximately 42%, constituted Warner's 'overhead'.

A. True.

Request No. 12. Warner's stock is publicly owned [445] and is listed on the New York Stock Exchange.

A. True.

Request No. 13. In 1945 Harry Warner was and still is Warner's president and chief executive.

A. True.

Request No. 14. In 1945 Jack Warner was and still is a Warner vice-president and an executive in charge of production.

A. True.

Request No. 15. The defendants Harry and Jack

Warner reside in California and look after matters requiring company attention on the West Coast and Albert Warner who resides in New York attends to matters in the East.

A. True in part; but it is also true that Harry Warner frequently, and Jack Warner occasionally, attends to matters requiring the company's attention in the East. [446]

* * * * *

Request No. 19. Between them, the three brothers own approximately 15% of Warner's outstanding stock.

A. True as of the year 1945; but from time to time the holdings of the three brothers vary in amount and in percentage of the outstanding stock.

Request No. 20. The rest of the said stock is distributed among approximately 30,000 shareholders located in various parts of the world. [447]

A. True.

Request No. 21. In the year 1945, the Warner Board of Directors was composed of eleven men.

A. True.

Request No. 22. Four of the said directors were lawyers, who, or the law firms in which they are partners, received substantial annual or other compensation from Warner.

A. True.

Request No. 23. Three of said directors were employees whom Warner paid substantial annual salaries.

A. True in part; until September 10, 1945, three

of said directors were employees of Warner; after that date only two were such employees.

Request No. 24. Only one of said directors, namely Waddill Catchings, was not on Warner's pay roll.

A. Not true; the directors Waddill Catchings, Morris Wolf, Charles S. Guggenheimer and John E. Bierwirth were not on Warner's payroll.

Request No. 25. Throughout 1945 Harry Warner and Jack Warner knew that each of the said seven directors who received compensation from Warner as hereinbefore described in previous requests and who sat on the Warner Board, was conscious of the fact [448] that opposition to the expressed views of the said Warner brothers on matters involved in the resolutions passed by the said Board on the 25th day of September, 1945, the 28th day of September, 1945, and the 23rd day of November, 1945, was fraught with danger to such director's private interests.

A. Not true. [449]

* * * * *

Request No. 29. Approximately 3 or 4 months before September 28, 1945, Harry Warner planned that an independent motion picture production company operated and controlled jointly by Milton Sperling and Joseph Bernhard would produce pictures in the [450] Warner studios.

A. Not true. The facts are that several months prior to September 28, 1945, Harry Warner conceived the idea that in view of the fact that Jack Warner was the only production head of Warner, that Warner should get some other competent per-

son connected with the organization in such manner that if Jack Warner should be unable to continue with his duties, the company would have available a competent and trained person to take his place. From this initial conception, by degrees and after much thought and many conferences, there was developed the idea which was finally put into effect of having an individual motion picture production company which should be operated and controlled by Milton Sperling and Joseph Bernhard and which would produce motion pictures at the Warner studios for Warner distribution.

Request No. 30. In the summer of 1945, Harry Warner and Jack Warner knew that Sperling was anticipating his discharge from military service in or about September of that year.

A. True.

Request No. 31. In the summer of 1945, Harry Warner and Jack Warner knew that Bernhard was [451] friendly with John S. Bierwirth, president of The New York Trust Company.

A. True. [452]

Request No. 32:

"Before and after August 4, 1945, Harry Warner and Jack Warner discussed said plan with Milton Sperling."

The answer is: "True."

Request No. 33:

"Before and after August 4, 1945, Harry Warner and Jack Warner discussed said plan with Joseph Bernhard."

The answer is: "True." * * * * * [453]

Request No. 37:

"In said discussions Harry Warner suggested to Bernhard, in substance, that he (Bernhard) try to influence John S. Bierwirth, president of The New York Trust Company, to approve the said bank loaning to an independent motion picture production company which [454] would be formed and owned equally by Bernhard and Sperling, on terms substantially like those contained in the agreement thereafter entered into between Warner, United and the said Trust Company on October 31, 1945, 50 per cent of the production costs of a series of motion pictures which would be produced by such independent company in the Warner studios."

The answer is: "Not true."

Request No. 39:

"Before August 4, 1945, Joseph Bernhard, acting in behalf of Warner, had been influential in procuring a loan or loans from The New York Trust Company to Warner."

The answer is: "True."

* * * * *

Request No. 41:

"Before August 4, 1945, Harry Warner and Jack Warner knew that Bernhard, acting in behalf of Warner, [455] had been influential in procuring a loan or loans from The New York Trust Company to Warner."

The answer is: "True."

* * * * *

Request No. 43:

"Before August 4, 1945, Bernhard told Harry

Warner in substance, that he (Bernhard) believed that he could procure The New York Trust Company to agree to loan an independent motion picture production company, which would be firmed and owned equally by Bernhard and Sperling, on terms substantially like those contained in the said agreement dated October 31, 1945, 50 per cent of the production cost of a series of motion pictures which said company would produce at the Warner studios."

The answer is: "True, except as to the terms referred to as contained in the agreement dated October 31, 1945, [456] as to which these answering defendant did not then know what, if any, terms would be contained in any agreement thereafter to be drawn, or what agreement or agreements if any, would be required to be drawn, and except that neither defendant can say positively that said statement was made either before or after August 4, 1945."

Request No. 44:

"Before August 4, 1945, Harry Warner and Jack Warner told Bernhard, in substance, that if he could procure The New York Trust Company to agree to loan to an independent motion picture production company which would be formed by and owned equally between him (Bernhard) and Sperling, on terms substantially like those contained in said agreement dated October 11, 1945, 50 per cent of the production cost of a series of motion pictures which such independent company would produce in the Warner studios, they (Harry and Jack War-

ner) would approve of Warner entering into an agreement with such an independent production company, whose terms would be substantially like those of the master agreement thereafter entered into between Warner and United."

The answer is: "True, as to Harry Warner, except the references [457] to the terms of an agreement dated October 31, 1945, as to which the situation is the same as that stated in response to request No. 43, and except that there was no reference to any terms dependent upon those of the master agreement referred to for the reason that at that time there was no knowledge on the part of anybody as to what those terms would ultimately be. As to defendant Jack Warner, the statement is untrue."

Request No. 45:

"On or about August 4, 1945, Harry Warner and Jack Warner knew that Sperling and Bernhard had agreed between themselves:

(a) To form an independent motion picture production company;

(b) That Sperling and Bernhard would each purchase 125 shares of the capital stock of the company so formed by them and pay \$12,500 therefor."

The answer is: "True." [458]

* * * * *

Request No. 47:

"Prior to August 4, 1945, Harry Warner and Jack Warner knew that Sperling had not theretofore engaged in the business of 'independent pro-

duction of motion pictures' as that term is known and understood in the motion picture industry."

The answer is: "True."

Request No. 56: "Prior to August 4, 1945, Harry Warner and Jack Warner knew that Bernhard had not theretofore engaged in 'independent production of motion pictures' as that term is known and understood in the motion picture industry."

The answer is: "True."

Request No. 57:

"Prior to August 4, 1945, Harry Warner and Jack Warner knew that Bernhard had approached John S. Bierwirth, president of The New York Trust Company, with a view to obtaining a commitment from said Bierwirth that the said bank would enter into an agreement with Warner and an independent motion picture production [459] company, which would be formed and owned equally by Bernhard and Sperling, the terms of which agreement would be substantially like the terms of the agreement subsequently entered into between Warner, United and the said bank on October 31, 1945."

The answer is: "True, as to Harry Warner, except as to the references to the terms of an agreement of October 31, 1945, as to which said defendant refers to the statement made in response to request No. 43, and as to the provisions with respect to the master agreement, the terms of which were then not known to either of the parties; untrue as to defendant Jack Warner."

Request No. 58:

"Prior to August 4, 1945, Bernhard told Harry

Warner, in substance, that he (Bernhard) desired Warner to pay him \$78,000 on severing his (Bernhard's) connection with Warner."

The answer is: "Not true."

Request No. 59:

"On or before September 11, 1945, Bernhard told Harry Warner and Jack Warner, in substance, that he had obtained a commitment from John S. Bierwirth, president of the New York Trust Company, that said bank [460] would make loans to United on terms substantially like those contained in the agreement which was subsequently entered into between said three parties and dated October 31, 1945."

The answer is: "As to Harry Warner, true; except as to the reference to the terms of the agreement of October 31, 1945, as to which the answer is the same as that made to request No. 43; not true as to Jack Warner."

Request No. 60:

"Before September 11, 1945, Harry Warner and Jack Warner knew that Sperling and Bernhard had entered into a stockholders agreement, which agreement is dated August 31, 1945."

The answer is: "True, except as to Harry Warner, that he did not know the terms of such agreement or its date; not true as to Jack Warner."

Mr. Levy: May I at this point call Mr. Williams' attention to the fact that the answer is somewhat unintelligible, probably due to an error on the part of the typist?

Mr. Williams: If there is any error, it is on my part.

Mr. Levy: The answer as it reads: "True, except as to Harry Warner"—it probably means true as to Harry Warner except that he did not know the terms of the agreement. [461]

Mr. Williams: That is correct.

Mr. Levy: Is that what you meant?

Mr. Williams: Yes.

The Court: May it be stipulated that the answer to Request No. 60, which appears on lines 26 through 28 on page 12 of Exhibit 110 may be amended to read:

"True, as to Harry Warner, except that he did not know the terms of such agreement or its date; not true as to Jack Warner"?

Mr. Williams: That is correct.

* * * * *

Mr. Levy: Request No. 61:

"On and before September 11, 1945, Harry Warner and Jack Warner knew that Bernhard had obtained a commitment from John S. Bierwirth, president of The New York Trust Company, to the effect that said bank would enter into an agreement with United and Warner, the terms of which agreement would be substantially like the terms of the agreement which was subsequently entered into between Warner, United, and the said Bank on October 31, 1945."

The answer is: [462] "True, except as to the reference as to the terms of an agreement of October 31, 1945, as to which they then knew nothing."

Request No. 62:

"Before the master agreement was drawn, the substance of its provisions was agreed upon in oral discussions between Harry Warner, Jack Warner, Milton Sperling, and Joseph Bernhard."

The answer is: "True." [463]

* * * * *

Mr. Levy: Then I shall re-read Request 63 and follow it with the answer thereto.

"Request No. 63. Prior to September 10, 1945, Harry Warner outlined to Herbert Freston, Esq., one of the attorneys for Warner, the substance of what he (Harry Warner) desired to be written into a proposed contract between Warner and United.

A. Not true; Harry Warner stated that Bernhard had caused United to be organized with Bernhard and Milton Sperling as stockholders and that said corporation would produce six pictures over a period of years for distribution by the Warner distributor. Warner told Freston what the distribution charge would be and that Price, Waterhouse & Co. was determining the overhead charge to the producer. Warner did not state the substance of what he desired written into the proposed contract but stated he and Bernhard had discussed only certain points to be covered by the agreement and asked Freston to contact Bernhard as to the points [464] discussed and then prepare the agreement as attorney for Warner, so as to be fair to both parties.

Request No. 64. On September 28, 1945, Harry Warner and Jack Warner knew the substance of

the terms which are contained in the master contract. A. True.

Request No. 65. The Thirty-First paragraph of the master contract provides:

‘If the Producer shall borrow from any banking association a substantial part of the cost (that is, that part of such cost as the Producer is obligated to pay hereunder) of producing any photoplay herein provided for, the Producer shall notify the Company, in writing, to that effect.’

At the time the master contract was signed Harry Warner and Jack Warner knew that United, Sperling and Bernhard intended, as provided in the Thirty-first paragraph thereof, to borrow from The New York Trust Company that part of each picture’s production cost as United was obligated to pay. A. True.

Request No. 66. At the time the master contract was signed, Harry Warner and Jack Warner knew that the total capital of United was \$25,000; that [465] Sperling and Bernhard had each purchased 125 acres of the capital stock of said company for \$12,500. A. True. * * * * *

Request No. 69. On September 11, 1945, Harry Warner and Jack Warner knew that Warner made United a cash loan for ‘general purposes’ in the sum of \$50,000.

A. True, as to defendant Harry Warner; not true as to defendant Jack Warner.

Request No. 70. On September 11, 1945, Harry Warner and Jack Warner knew that Warner and United would enter into and execute an agreement

the substance of the terms of which would be that contained in the master contract subsequently signed by said parties on September 28, 1945. [466]

A. On September 11, 1945 Harry and Jack Warner believed and intended that Warner and United would enter into an agreement as described in this request; but, of course, they did not know that such agreement would be executed."

And I would call your Honor's attention to the fact that the answering defendants underscored the word "know" on line 7 of page 15 of this Exhibit 110 in evidence.

"Request No. 71. On September 11, 1945, Harry Warner and Jack Warner knew that after the said master contract would be signed by Warner and United, the same would be implemented by a contract between Warner, United and The New York Trust Company, the substance of the terms of which would be that contained in the contract subsequently entered into between the said three parties on October 31, 1945.

A. Not true.

Request No. 72. Subdivision 4½ of Paragraph Seventh (a) of the master contract provides:

'Out of the gross receipts retained by the Company it shall pay to the Producer, by way of reimbursement, a sum equal to all costs and expenses paid or incurred by the Producer in the production of each of the photoplays herein provided for, which costs of the Producer shall include a [467] reasonable allowance for its operating and general overhead in connection with the production of each

such photoplay. Such overhead shall include such reasonable executive salaries as the Producer shall pay to Joseph Bernhard and Milton Sperling and other production employees; provided, however, that any part of such salaries which may properly be charged to a picture as a "direct charge" shall not be included in computing the Producer's general overhead.'

Before the master contract was signed, neither Harry Warner nor Jack Warner indicated to Sperling or Bernhard what he (Harry Warner and Jack Warner) considered a 'reasonable allowance' for United's 'operating and general overhead', above referred to. A. True.

Request No. 73. Before the master contract was signed, neither Harry Warner nor Jack Warner indicated to Sperling or Bernhard what salaries he would consider 'reasonable executive salaries.'

A. Harry and Jack Warner both indicated to Sperling and Bernhard the salaries they would consider 'reasonable executive salaries' but as to whether this matter was discussed before or [468] after the master contract was signed, neither defendant can state.

Request No. 74. Before and at the time of the execution of the master contract Harry and Jack Warner knew that never before had Warner entered into a contract with an independent producer which gave the producer the same benefits and advantages as provided in said master contract.

A. Not true. Each contract entered into between Warner and an independent producer gave to War-

ner and such producer certain benefits and advantages which in many particulars were identical and in general were the same or similar to those provided in the master contract but which in many details differed from contract to contract. The question of whether the provisions of each contract gave to the producer benefits or advantages which were the same or less or similar to those provided in the master contract is a matter of opinion and a matter which can only be determined by the ultimate results of each contract. For that reason, these defendants are unable to state categorically as to any contract whether it gave the producer the same, greater, lesser or similar benefits and advantages to those given other producers under other contracts. * * * * * [469]

Request 76. Before and at the time of the execution of the master contract, Harry Warner and Jack Warner knew that Warner had never before entered into a contract with an independent producer, by the terms of which contract Warner incurred the same risks as it incurred by the master contract.

A. Not true. Defendants repeat the answer to request No. 74 as the answer to this request. In addition thereto, it should [470] be pointed out that every contract with an independent producer and every undertaking by Warner to make feature motion pictures involves numerous risks to Warner to the full extent and in many cases beyond the total production cost of said picture. The amount and character of such risks to Warner to the full

extent and in many cases beyond the total production cost of said picture. The amount and character of such risks are determined by numerous circumstances, including general business conditions, current attitude of the public towards entertainment, type of picture involved, the story, the stars, the integrity, character and ability of the producer and director, and numerous other matters, too many to enumerate, all of which must be weighed to determine the extent and seriousness of the risks involved. A weighing of all such factors and the determination of whether such picture should be produced is a matter of business judgment; and the question of whether the incurring of such risks is justifiable from a business standpoint is ultimately proved only from the results obtained. In any event, the making of a contract with any independent producer as well as the making of any picture by Warner itself involves [471] risks which are broadly like and similar to those incurred by the master contract. * * * * * [472]

Request No. 87:

"In or about November, 1945, Harry Warner nominated John S. Bierwirth as a Warner director to fill the vacancy created by Bernhard's resignation as a director."

The answer is: "True."

Request No. 88: [477]

"In November, 1945, John S. Bierwirth was elected a Warner director."

The answer is: "True."

Request No. 89:

“On February 15, 1946, Harry Warner knew that Warner made a cash loan to United for ‘general purposes’ in the sum of \$100,000.”

The answer is: “True.”

Request No. 90:

“On February 15, 1946, Harry Warner and Jack Warner knew that the master contract contained no provision for ‘general purposes’ loans by Warner to United.”

The answer is: “True.” * * * * * [478]

Request No. 96. On September 18, 1946, Harry Warner and Jack Warner knew that Bernhard sold his interest in United to Sperling for \$400,000 cash.

A. True.

Request No. 97. On September 18, 1946, Harry Warner and Jack Warner knew that Sperling had borrowed \$400,000 from The New York Trust Company for the purpose of purchasing Bernhard’s stock in United. A. True.

Request No. 98. On September 18, 1946, Harry Warner and Jack Warner knew that Mrs. Betty Sperling, Harry Warner’s daughter, had deposited with said New York Trust Company collateral owned by her for the purpose of securing the said loan. A. True.

Request No. 99. In or about December, 1946, Harry Warner and Jack Warner knew that Sperling assigned 62 shares of United capital stock to The Title Insurance and Trust Company of Los Angeles as trustee, to be held in trust for the benefit

of the minor children of Milton and Betty Sperling.

A. True. [481]

“Request No. 100. Since November 7, 1945, Harry Warner and Jack Warner knew that the ‘budget’ of each of the pictures which United produced under the master contract and its amendments was prepared by United.

A. Not true as to Harry Warner; true as to Jack Warner.

* * * * *

Request No. 104. Before December 6, 1947, Sperling [482] told Harry Warner that he (Sperling) was unwilling to proceed with the production of the three pictures which then remained unproduced.

A. True only to the extent that he was temporarily unwilling to proceed.

Request No. 105. On December 6, 1947 Warner and United entered into an amendment to the master contract bearing that date.

A. True.”

That amendment, if the court please, is Exhibit No. 4 in evidence.

Mr. Williams: Exhibit 4.

The Court: Stipulated?

Mr. Williams: So stipulated, your Honor.

Mr. Levy: “Request No. 106. On or before December 6, 1947 Sperling, acting on behalf of United, and Harry Warner and Jack Warner acting on behalf of Warner, orally agreed on the substance of the terms of the said amendment.

A. True.

Request No. 107. On December 6, 1947 Harry

Warner and Jack Warner knew the substance of the terms of the said amendment.

A. True.

Request No. 108. On December 9, 1947 Warner [483-484] and United entered into a further amendment to the master contract. A. True.

Request No. 109. On December 9, 1947 Harry Warner and Jack Warner knew the substance of the terms of the amendment bearing that date.

A. True."

The amendment referred to in the two previous requests is Exhibit No. 5 in evidence.

Mr. Williams: So stipulated, your Honor.

Mr. Levy: "Request No. 110. On or before December 6, 1947 Harry Warner and Jack Warner knew that Warner had paid Bernhard the sum of \$78,000 as 'severance pay' in installments of \$3,000 commencing with the week of November 7, 1945.

A. True.

Request No. 111. On or before December 6, 1947 Harry Warner and Jack Warner knew that the actual production cost of 'Clock and Dagger' exceeded the budgeted cost thereof by over a quarter of a million dollars.

A. Not true as to Harry Warner; true as to Jack Warner. [485]

* * * * *

Request No. 113. On December 6, 1947 Harry Warner knew that the actual production cost of 'My Girl Tisa' exceeded the budgeted cost thereof by over \$100,000. A. Not true.

* * * * *

Request No. 116. On and before December 6, [486] 1947, Harry Warner and Jack Warner knew that United had borrowed \$814,090 from The New York Trust Company in connection with the production of 'My Girl Tisa.'

A. True in part; they knew that United had borrowed from The New York Trust Company, but not the amount. [487]

* * * * *

Request No. 118:

"Before December 6, 1947, Harry Warner and Jack Warner knew that percentagewise Warner's overhead for the period commencing March 3, 1946, to March 1, 1947, was greater than Warner's overhead during the period commencing February 24, 1944, to February 24, 1945."

The answer is: "True."

Request No. 119:

"Before December 6, 1947, Harry Warner and Jack Warner knew that percentagewise Warner's overhead during the year 1947 was greater than Warner's overhead during the period commencing February 24, 1944, to February 24, 1945."

The answer is: "True." [488]

Request No. 132. "On or before December 6, 1947 Harry Warner and Jack Warner knew that United had theretofore delivered to Warner a statement of United's overhead for the year 1946.

A. Not true as to defendant Harry Warner; true as to Jack Warner.

Request No. 133. On or before December 6, 1947 Harry Warner and Jack Warner knew that said

statement disclosed that United overhead, allocated to the production cost of the two pictures completed by United during that year, namely 'Cloak and Dagger' and 'Pursued,' was in excess of \$200,000. [494]

A. Not true as to defendant Harry Warner; true as to Jack Warner.

Request No. 134. On or before December 6, 1947 Harry Warner and Jack Warner knew that a sum in excess of \$200,000, representing United overhead incurred by United during 1946 was allocated by United to the production cost of the pictures 'Cloak and Dagger' and 'Pursued,' and made a part of the total production cost of said pictures.

A. Not true as to defendant Harry Warner; true as to Jack Warner.

Request No. 135. On or before December 6, 1947 Harry Warner and Jack Warner knew that included in United's overhead, referred to in requests Nos. 132 to 134 inclusive, was:

(a) An item in excess of \$50,000 relating to stories and/or story rights and/or scenarios purchased or otherwise acquired by United which were not related to the pictures 'Clock and Dagger' and 'Pursued' and were not used by United but which were abandoned and written off by United as worthless.

(b) An item of \$25,000 paid by United to Prinzmetal & Grant, attorneys; that said attorneys had rendered no legal services therefor; that said [495] \$25,000 was paid by United to said attorneys as a commission in connection with United's obtaining

the services of Gary Cooper for 'Cloak and Dagger.'

(c) An item in excess of \$20,000 paid by United to Donald Hyde for services performed by him as an assistant to Sperling, and that Hyde, as such assistant, had rendered services in connection with the production of 'Clock and Dagger' and 'Pursued.'

* * * * *

"(d) An item in excess of \$20,000 paid to Oliver B. Schwab and Schwab & Shapiro, attorneys for United; and that said attorneys had rendered legal services in connection with the production of said pictures.

(e) An item of \$7500 to Hemisphere's attorney [496] and that such attorney had rendered legal services in connection with the production of 'Pursued.'

(f) An item in excess of \$22,000 paid to Bernhard for services as an 'executive' of United.

A. Not true as to defendant Harry Warner, true as to Jack Warner except as to the statement concerning legal services of Printzmetal & Grant. [497]

* * * * *

Request No. 137:

"On December 6, 1947, Harry Warner and Jack Warner knew that Warner had advanced in excess of \$800,000 as its share of the production cost of My Girl Tisa."

The answer is:

"Not true as to defendant Harry Warner; true as to Jack Warner."

Request No. 138:

"On December 6, 1947, Harry Warner and Jack

Warner knew that United had produced and completed the production *My Girl Tisa*; that the said picture had theretofore been exhibited to the military forces of the United States."

The answer is:

"Not true as to defendant Harry Warner; true as to Jack Warner."

* * * * *

Request No. 140:

"On and before August 1, 1948, Harry Warner and [498] Jack Warner knew that in all probability Warner would suffer a production loss in connection with *My Girl Tisa*."

The answer is: "Not true."

Request No. 141:

"On August 1, 1948, Harry Warner and Jack Warner knew that Warner would suffer a production loss in connection with *My Girl Tisa*."

The answer is: "Not true."

Request No. 142:

"On and before July 21, 1950, Harry Warner and Jack Warner knew that Warner had suffered a production loss in connection with *My Girl Tisa*."

The answer is:

"If by 'suffered a production loss' is meant that the rentals from the film, less proper deductions, had not equaled the cost of production, the answer is true as to Jack Warner, not true as to Harry Warner."

Request No. 143:

"On July 21, 1950, Harry Warner and Jack Warner knew that Warner entered into an amendment

to the master contract which is dated July 21, 1950.”

The answer is: “True.” [499]

That amendment, if your Honor please, is in evidence as Exhibit No. 7.

Request No. 144:

“At the time said amendment was executed, Harry Warner and Jack Warner knew the substance of its terms.”

The answer is: “True.”

Request No. 145:

“On July 21, 1950, Harry Warner and Jack Warner knew that in 1948 United had produced South of St. Louis as an ‘additional’ picture, and that in 1949 United had produced Three Secrets as an ‘additional’ picture.”

The answer is: “True.”

* * * * *

Request No. 152:

“On or before July 21, 1950, Harry Warner and Jack Warner knew that percentagewise Warner’s overhead for the period commencing February 29, 1948, to February 26, 1949, was greater than Warner’s overhead during the period commencing February 24, 1944, to February 24, 1945.”

The answer is: “True.”

Request No. 153:

“On or before July 21, 1950, Harry Warner and Jack Warner knew that percentagewise Warner’s overhead during the period commencing February 24, 1949, and terminating February 24, 1950, was greater than [502] Warner overhead during the

period commencing February 24, 1944, to February 24, 1945."

The answer is: "True."

Request No. 154:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that the actual production cost of the picture *South of St. Louis* exceeded the budgeted cost thereof by approximately \$150,000."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 155:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that United had theretofore delivered to Warner a statement of United's overhead for the year 1947."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 156:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that said statement disclosed that United overhead, allocated to the production cost of *My Girl Tisa*, which was completed by United during 1947, was in excess of \$200,000."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner." [503]

Request No. 157:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that a sum in excess of \$200,000, representing overhead incurred by United during

1947, had been allocated by United to the production cost of *My Girl Tisa*, and made a part of the total production cost of that picture."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 158:

"On or before July 21, 1950, Harry Warner and Jack Warner knew that included in United's overhead, referred to in requests numbers 156 and 157, was:

"(a) An item in excess of \$40,000 relating to stories and/or story rights and/or scenarios purchased or otherwise acquired by United which were not related to the picture *My Girl Tisa* and were not used by United but were abandoned and written off by United as worthless;

"(b) An item in excess of \$20,000 paid to Sperling for services rendered by him in the capacity of an 'executive' to United;

"(c) An item in excess of \$35,000 paid to Donald Hyde for services rendered by him as an assistant to Sperling in the production of said picture; [504]

"(d) An item in excess of \$18,000 paid to United's attorneys for services rendered by them in connection with the production of said picture;

"(e) An item in excess of \$10,000 representing salaries paid to actors who rendered no services in consideration of said money paid them."

The answer is:

"Not true as to Harry Warner; true as to Jack Warner."

Request No. 159:

“On July 21, 1950, Harry Warner and Jack Warner knew that United had theretofore delivered to Warner a statement of United’s overhead for the year 1948.”

The answer is:

“Not true as to Harry Warner; true as to Jack Warner.”

Request No. 160:

“On July 21, 1950, Harry Warner and Jack Warner knew that said statement disclosed United’s overhead allocated to the production cost of the picture *South of St. Louis* was in excess of \$100,000.”

The answer is:

“Not true as to Harry Warner; true as to Jack Warner.”

Request No. 161:

“On or before July 21, 1950, Harry Warner and Jack Warner knew that a sum in excess of \$100,000 representing overhead incurred by United in 1948 had been [505] allocated by United to the production cost of *South of St. Louis*, and made a part of the total production cost of that picture.”

The answer is:

“Not true as to Harry Warner; true as to Jack Warner.”

Request No. 162:

“On or before July 21, 1950, Harry Warner and Jack Warner knew that included in United’s overhead referred to in request Numbers 160 and 161, was:

“(a) An item in excess of \$18,000 paid to Sperling for services rendered in his capacity as a United ‘executive’;

“(b) An item in excess of \$30,000 paid to Donald Hyde, who rendered services as an assistant to Sperling in the production of said picture;

“(c) An item in excess of \$13,000 paid to J. C. Yoss who rendered services as an accountant in connection with the production of said picture;

“(d) An item in excess of \$13,000 paid to United’s attorneys who rendered services in connection with the production of said picture.”

The answer is:

“Not true as to Harry Warner; true as to Jack Warner.” [506]

* * * * *

Request No. 168. On August 12, 1952, Harry Warner knew that Warner had entered into an amendment to the master contract which was dated that day. A. True.” [508]

That amendment, if the court please, is attached to Exhibit 107 and is contained in Schedule H of Exhibit 107 in evidence.

“Request No. 169. At the time said amendment was executed, Harry Warner and Jack Warner knew the substance of its terms.

A. True.

Request No. 170. On August 12, 1952, Harry Warner and Jack Warner knew that no picture had been produced by United during 1952 and up to August 12 of that year. A. True.

Request No. 171. On August 12, 1952, Harry

Warner and Jack Warner knew that throughout the year of 1952 and up to said day, United had not engaged in principal photography on any picture.

A. True. * * * * * [509]

Request No. 175. On or before August 12, 1952, Harry Warner and Jack Warner knew that during 1952 and up to said date, United had paid Sperling \$1500 a week for services rendered and expenses incurred by Sperling. A. True.

Request No. 176. On or before August 12, 1952, Harry Warner and Jack Warner knew that percentage-wise Warner's overhead for the period commencing February 26, 1950 and terminating February 24, 1951 was greater than Warner's overhead during the period commencing February 24, 1944 to February 24, 1945. A. True.

Request No. 177. On or before August 12, 1952, Harry Warner and Jack Warner knew that percentage-wise [510] Warner's overhead for the period commencing February 25, 1951 and terminating March 1, 1952 was greater than Warner's overhead during the period commencing February 24, 1944 to February 24, 1945. A. True.

Request No. 178. On August 12, 1952, Harry Warner and Jack Warner knew that in 1951 United produced 'Distant Drums' and 'Retreat, Hell!'

A. True.

Request No. 179. On August 12, 1952, Harry Warner and Jack Warner knew that the actual production cost of the picture 'Distant Drums' exceeded the budgeted cost thereof by over a quarter of a million dollars, and that the actual production

cost of the picture 'Retreat, Hell!' exceeded the budgeted cost of that picture by over \$150,000.

A. Not true as to Harry Warner; true as to Jack Warner. [511]

* * * * *

Request No. 188. Since September 18, 1946, Harry Warner and Jack Warner have known that United's business policies were determined solely by Sperling. A. True. [514]

* * * * *

Request No. 190. Since September 18, 1946 Harry Warner and Jack Warner knew that whether United should or would abandon and write off a literary property purchased or acquired by United for the purpose of making a motion picture was determined solely by Sperling. A. True.

Request No. 191. Since September 18, 1946, Harry Warner and Jack Warner have known that whether United should sell or otherwise dispose of a literary property purchased or acquired by United for the purpose of making a motion picture was determined solely by Sperling.

A. Not true.

Request No. 192. Sub-paragraph 6 of paragraph Seventh (a) of the master contract provides as follows:

'The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are incurred in [515] connection with such production

program, the Company shall, weekly, on proper vouchers or billing from the Producer, reimburse the producer for a sum equal to one-half of such obligations, * * *

Since September 18, 1946, Harry Warner and Jack Warner have known that any and all contractual obligations incurred by United, and any and all commitments made by United, which are referred to in the above quoted paragraph, were determined to be so incurred and were determined to be so made solely by Sperling.

A. True, except for the control exercised by Warner's right to approve or disapprove the budget of each picture.

Request No. 193. Since September 18, 1946, Harry Warner and Jack Warner have known that the amount of compensation paid by United to Sperling for services rendered by him was determined solely by Sperling.

A. True, except for the limitation contained in the master contract that such compensation must be 'reasonable.'

Request No. 194. Since September 18, 1946, Harry Warner and Jack Warner have known that the [516] amount of compensation which United should or would pay to 'production employees.' referred to in sub-paragraph 4½ of paragraph Seventh (a) of the master contract, and quoted herein on p. 121½, line 13, was determined solely by Sperling.

A. True.

Request No. 195. Since September 18, 1946, Harry Warner and Jack Warner have known that the

compensation which United should or would pay to any and all persons in United's employ was determined solely by Sperling. A. True.

Request 196. Since September 18, 1946, Harry Warner and Jack Warner have known that the price of any item of property purchased or acquired by United in the course of the production of pictures was determined solely by Sperling.

A. True.

Request No. 197. Since December 7, 1946, Harry Warner and Jack Warner have known"—

That is an error.

Mr. Williams: It is pointed out in the answer.

Mr. Levy: Yes. It should be "December 6, 1947" instead of "December 7, 1946," and it is pointed out in the answer, your Honor. May I at this time move to correct Request No. [517] 197 so as to read: "Since December 6, 1947"?

Mr. Williams: Mr. Levy, may I suggest that if you leave it the way it is now, it is perfectly clear. If you amend it now, then you have got to change the answer, too, and that makes it that much more difficult.

Mr. Levy: Oh.

The Court: You have the commitment you seek, do you not?

Mr. Levy: Yes, your Honor. And I shall read it. The request, then, is:

Request No. 197. "Since December 7, 1946, Harry Warner and Jack Warner have known that whether a picture thereafter produced by United should or would be a 'remaining original' picture or an 'addi-

tional' picture was determined solely by Sperling.

A. Not true, since December 7, 1946, but it is true since December 6, 1947.

Request No. 198. Since September 18, 1946, Harry Warner and Jack Warner have known that the dates upon which United would pay its obligations to Warner, in connection with facilities made available to United by Warner in the making of 'original' pictures, was determined solely by Sperling.

"A. Not true. [519]

* * * * *

Mr. Levy: I offer in evidence Exhibit 111, being a document entitled "Answers by Defendant Warner Bros. Pictures, Inc. to Request for Admissions Dated March 30, 1953."

* * * * *

(Plaintiff's Exhibit No. 111 for identification was thereupon received in evidence.)

Mr. Levy: Request No. 1:

"Meetings of the Warner Board of Directors are held in New York City. Albert Warner customarily presides at such meetings, except on those occasions when Harry Warner is present.

"A. True."

Request No. 2:

"No stenographic notes are taken of the proceedings held at Board meetings. Minutes are made and kept. [523] "A. True."

Request No. 3:

"The collective opinion of Harry, Jack, and Albert Warner on matters presented at Board meetings and the action desired by them to be taken

thereon are voiced by the generally presiding Albert Warner.

"A. True in part; not true in part. If the Warner Brothers are in accord, their views are expressed at board meetings either by Harry Warner or Albert Warner. Sometimes they are not in agreement, in which case those present express their several views. Sometimes matters are brought before the board as to which they have not theretofore formed an opinion, in which case each expresses his own view. Never do any of the brothers express a personal desire as to what action of the board should be."

Request No. 4:

"At a special meeting of the Warner Board held on September 25, 1945, the following resolution was unanimously adopted:

" 'Resolved: That the officers of the Corporation be authorized to terminate the employment agreement of Joseph Bernhard with the mutual consent of Mr. Bernhard and the Corporation, such termination to be effective on November [524] 7, 1945, and that Mr. Bernhard be paid the sum of Seventy-eight Thousand (\$78,000) Dollars as severance pay, such sum to be payable in twelve (12) monthly installments commencing on December 1, 1945.' "

Mr. Williams: Incidentally, the minutes from which that excerpt has been taken have already been marked in evidence in this case, I believe. I think it might be of assistance if we indicated the exhibit number.

Mr. Levy: Yes; I was about to say, your Honor,

that the resolution which I had read is from Exhibit 17 in evidence.

The Court: So stipulated?

Mr. Williams: So stipulated, your Honor.

Mr. Levy: The request proceeds as follows:

“Before the Board voted on the above resolution, Albert Warner, who presided at said meeting, stated, among other things and in substance:

(a) That Bernhard and Sperling, Harry Warner’s son-in-law, had organized a motion picture company, namely, United;

(b) That United was about to embark on the making of a series of pictures at the Warner studios, under a contract with Warner which was being prepared, the substance of which contract [525] had been agreed upon between Harry and Jack Warner, on behalf of Warner, and by Bernhard and Sperling, on behalf of United.

A. True as to the fact and the wording of the resolution quoted; true that before the board voted on said resolution, Albert Warner stated in substance that Bernhard and Milton Sperling, Harry Warner’s son-in-law, were to join in United States Pictures, which would engage in the production of motion pictures to be distributed by Warner Bros. Otherwise, not true.”

Request No. 5:

“Before the Warner Board voted on the said resolution dated September 25, 1945, Albert Warner told the directors present, among other things and in substance, that he and Harry and Jack Warner desired the adoption of the said resolution.

A. Not true." [526]

* * * * *

Request No. 12. The first picture, namely 'Cloak and Dagger', was photographed and completed in 1946 and has been exhibited since August of 1946.

A. True.

Request No. 13. The second picture, namely 'Pursued' was photographed and completed in 1946 and has been exhibited since January 1947.

A. True in part, except that said picture was first exhibited March 8, 1947.

Request No. 14. The third picture, namely 'My Girl Tisa', was photographed and completed in 1947 and has been exhibited since November, 1947.

A. True, except that the first exhibition of said picture was February 7, 1948.

Request No. 15. The fourth picture, namely [533] 'South of St. Louis', was photographed and completed in 1948 and has been exhibited since January of 1949.

A. True, except that the first exhibition of said picture was March 12, 1949.

Request No. 16. The fifth picture, namely, 'Three Secrets', was photographed and completed in 1949 and has been exhibited since the early part of 1950.

A. True, except that said picture was first exhibited October 14, 1950.

Request No. 17. The sixth picture, namely 'The Enforcer' was photographed and completed in 1950 and has been exhibited since January of 1951.

A. True, except that said picture was first exhibited February 24, 1951.

Request No. 18. The seventh picture, namely 'Distant Drums', was photographed and completed in 1951 and has been exhibited since December of 1951.

A. True.

Request No. 19. The eighth picture, namely 'Retreat, Hell', was photographed and completed in 1951 and has been exhibited since February of 1952. [534] "A. True.

Request No. 20. United did not photograph any pictures in 1952.

A. True." [535]

Request No. 21:

"The ninth picture, namely Blowing Wild, is presently in the process of being photographed. Principal photography thereon was begin in February of 1953. A. True." [536]

* * * * *

Request No. 30:

"Warner paid Bernhard Seventy-eight thousand (\$78,000) Dollars in installments of Three Thousand (\$3,000) Dollars a week, commencing December 1, 1945."

Mr. Williams: If your Honor please, may I state in this connection, although I waive the objection to that question, I do not waive the point that the element of paying Bernhard severance pay of \$78,000 is within the issues of this case as such.

My view is, if this has any relevancy or admissibility, it is only in connection with the allegations of the complaint to the effect that contracts were made for the purpose of enriching the son-in-law of Harry Warner and to the detriment of Warner

Brothers Pictures, Inc. But I do not concede that this particular point is an issue in the case as such.

Mr. Levy: The answer is: "True." [540]

* * * * *

Mr. Levy: I shall start again with Request 31:

"At no meeting of the stockholders of Warner were the stockholders advised of the following:

"(a) The substance of the master contract and/or its amendments. "A. Not true.

"(b) The substance of the contracts entered into between Warner and United and The New York Trust Company. "A. Not true.

"(c) The substance of the agreement between United and Hemisphere Films, Inc., dated May 20, 1946. "A. True.

"(d) That Milton Sperling was Harry Warner's son-in-law. "A. Not true.

"(e) That Sperling owned 50 per cent of United's outstanding capital stock, between September 28, 1945, and September 18, 1946. "A. True.

"(f) That on September 18, 1946, Sperling acquired the remaining 50 per cent of United's outstanding stock. "A. True.

"(g) That, for the purpose of acquiring the remaining 50 per cent of United's capital stock, Sperling personally borrowed Four Hundred Thousand (\$400,000) Dollars from The New York Trust Company. [542] "A. True.

"(h) That on or about September 16, 1946, Mrs. Betty Sperling, the wife of Milton Sperling and the daughter of Harry Warner, deposited certain stock, owned by her, of Warner Bros. Pictures with

the New York Trust Company as security for the repayment of the said loan. A. "True.

"(i) That, since December, 1946, Sperling has owned all the outstanding capital stock of United, with the exception of 62 shares. "A. True.

"(j) That, since December 23, 1946, said 62 shares have been held by the Title Insurance and Trust Company of Los Angeles, California, as Trustee, for the benefit of the minor children of Milton and Betty Sperling, which children are Harry Warner's grandchildren. "A. True." [543]

* * * * *

This exhibit, if the court please, is dated April 6, 1953. It is verified by Roy J. Obringer on the 3rd day of April, 1953.

I proceed, your Honor, to Exhibit 112 which I offer in evidence.

* * * * *

(The document was thereupon marked Plaintiff's Exhibit No. 112 and received in evidence.)

Mr. Levy: This exhibit contains a series of requests for admissions addressed to the defendant Milton Sperling. [547]

* * * * *

Request No. 4. Beginning with the autumn of 1934 and up to and including part of 1939, Sperling was employed as a writer, first by Fox Films and thereafter by its successor, 20th Century Fox.

A. True.

Request No. 5. In 1939, Sperling's status at 20th Century Fox was changed to that of an employee producer. A. True.

Request No. 6. In 1939, Sperling was married to Miss Betty Warner, the daughter of Harry Warner.

A. True.

Request No. 7. The actual production of each of the pictures made by 20th Century Fox, in the making of which Milton Sperling was employed to act and did act as a producer, was not within his exclusive control.

A. True in part, the fact being that as to those pictures of which the defendant was the [548] producer, this defendant exercised the exclusive control customarily exercised by producers at said studio. All producers and all employees were subject to the studio head.

Request No. 8. The subject matter, the preparation of the screen play, the cutting and editing of each picture in the making of which Milton Sperling was employed by 20th Century Fox as a producer, were not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 9. The selection of the story upon which each such picture was based was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 10. The selection of the person who was to function as the director of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 11. The selection of the persons who

were to star or play the leading roles in each of such pictures was not within Sperling's exclusive control. [549]

"A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 12. The selection of the cast of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 13. The preparation of the budget for each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 14. The compensation to be paid to the director and to members of the cast of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 15. The selection of the title of each such picture was not within Sperling's exclusive control.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 16. The cost of the items which entered into the production of each such picture [550] both before and after the commencement of principal photography thereof, was subject to the approval of an executive or executives of 20th Century Fox.

A. True in part, and the answer to request No. 7 is hereby incorporated.

Request No. 17. As such producer, Milton Sperling was not authorized to purchase literary properties without first obtaining the approval of his employer. A. True.

Request No. 18. As such producer, Sperling was not authorized to employ writers to compose literary properties and/or develop screenplays without first obtaining the approval of his employer.

A. True.

Request No. 19. Between 1942 and September of 1945, Sperling was in the military service.

A. True.

Request No. 20. Prior to the incorporation of United, Sperling discussed the proposed formation thereof with Harry Warner and Jack Warner and with Joseph Bernhard. A. True. [551]

Request No. 21. Prior to the incorporation of United, Milton Sperling discussed with Harry and Jack Warner and with Joseph Bernhard, terms of a proposed contract between United and Warner.

A. True to the extent that prior to the date of incorporation this defendant discussed terms in broad outline. [552]

* * * * *

Request No. 26:

“On or before September 10, 1945, Sperling knew that Bernhard had obtained a commitment from the said John S. Bierwirth, that the said Bank would make loans to United on terms substantially

like those contained in the said agreement dated October 31, 1945.

“A. True except that this defendant did not know on or before September 10, 1945, the terms which would be contained in the agreement to be drawn.”

Request No. 27:

“On August 31, 1945, Sperling and Bernhard executed a stockholders agreement which is dated that day. “A. True.”

Request No. 28:

“Before the master contract was drawn, the substance of its provisions was agreed upon in oral discussions between Harry Warner, Jack Warner, Sperling, and Bernhard.

“A. True except that this defendant did not participate in all of the discussions concerning the proposed agreement.”

Request No. 29:

“At the time the master contract was signed, United’s total capital consisted of \$25,000 cash.

“A. True.” [554]

* * * * *

Request No. 32:

“On September 11, 1945, Sperling, acting on behalf of United, borrowed \$50,000 from Warner.

“A. True that said sum was borrowed, but said loan was made by Bernhard on behalf of United.”

* * * * * [555]

Request No. 34:

“Subdivision 4½ of paragraph Seventh (a) of the master contract provides:

‘Out of the gross receipts retained by the Company it shall pay to the Producer by way of reimbursement, a sum equal to all costs and expenses paid or incurred by the Producer in the production of each of the photoplays herein provided for, which costs of the Producer shall include a reasonable allowance for its operating and general overhead in connection with the production of each such photoplay. Such overhead shall include such reasonable executive salaries as the Producer shall pay to Joseph Bernhard and Milton Sperling and other production employees; provided, however, that any part of such salaries which may properly be charged to a picture as a ‘direct charge’ shall not be included in computing the Producer’s general overhead.’

Before the master contract was signed, Sperling did not indicate to either Harry Warner or to Jack Warner, in words or substance, what salaries he (Sperling) would consider ‘reasonable executive salaries.’ [556]

Before the master contract was signed, Sperling did not indicate to either Harry Warner or Jack Warner, in words or substance, what allowance he considered ‘a reasonable allowance’ for United ‘operating and general overhead.’ “A. True.”

Request No. 35:

“Before the master contract was signed, Sperling did not receive any communication from Warner which, in words or substance, set forth Warner’s definition in terms of dollars, of the word ‘reasonable’ in the paragraph quoted above.

“A. True.”

Request No. 36:

“The budget of each of the pictures which United has made under the master contract and its amendments was prepared by Sperling.

A. Not true. Said budgets were prepared by United and not solely by this defendant.” [557]

* * * * *

Request No. 41: [558]

“Before September 18, 1946, Sperling authorized Stanleigh P. Friedman to draw a written contract of purchase and sale of said 125 shares; the price, \$400,000 payable to Bernhard in cash simultaneously with the execution and delivery by Bernhard to Friedman of the said contract.

“A. True.”

* * * * *

Request No. 43:

“On or before September 18, 1946, Sperling caused to be delivered to Friedman a cashier’s check in the sum of \$400,000 drawn on The New York Trust Company. “A. True.”

Request No. 44:

“On September 18, 1946, Friedman delivered said cashier’s check to Bernhard and the latter delivered a signed copy of said contract to Friedman together with his (Bernhard’s) 125 share stock certificate, and his resignation as an officer and director of United. “A. True.”

Request No. 45:

“Before September 18, 1946, Sperling borrowed

the [559] \$400,000 referred to in the previous request from The New York Trust Company.

"A. True."

Request No. 46:

"Before September 18, 1946, Sperling executed his promissory note payable to The New York Trust Company in the sum of \$400,000. "A. True."

Request No. 47:

"Mrs. Betty Sperling, the wife of Milton Sperling, was either a co-maker with Sperling of said promissory note or the same was endorsed by her.

"A. Not true."

Request No. 48:

"On or before September 18, 1946, Mrs. Betty Sperling delivered to said bank collateral security, to secure the payment of the said promissory note.

"A. True." [560]

* * * * *

The Court: You may proceed.

Mr. Levy: The last request that I have read, your Honor, is No. 48. I proceed now to the reading of No. 49.

"Request No. 49. On or soon after September 18, 1946, Sperling told Harry Warner and Jack Warner in substance:

(a) That he purchased Bernhard's stock interest in United for \$400,000 cash;

(b) That he borrowed the money from The New York Trust Company;

(c) That he had executed his promissory note payable to the order of said bank;

(d) That Mrs. Betty Sperling had secured the

payment of the said note to the bank in the manner described in requests 45 to 48, both inclusive.

A. True except that with reference to subparagraph (d) of request 49, this defendant did not tell Harry Warner or Jack Warner that Mrs. Betty Sperling was a co-maker of said promissory note or that the same was endorsed by her.

Request No. 50. In December of 1946, Sperling transferred 62 of his shares of United capital stock to the Title Insurance and Trust [561] Company of Los Angeles as trustee, for the benefit of his and Mrs. Betty Sperling's minor children.

A. True.

Request No. 51. In or about December, 1946, Sperling told Harry Warner and Jack Warner that he had made the transfer of capital stock referred to in the previous request. A. True.

Request No. 52. Since September 18, 1946, Sperling has controlled the action of the Board of Directors of United. A. Not true.

Request No. 53. Since September 18, 1946, United's business policies were determined solely by Sperling. A. True.

Request No. 54. Since September 18, 1946, the persons who have composed United's Board of Directors were selected solely by Sperling.

A. Not true. The Directors have at all times since September 18, 1946 been elected by unanimous vote of all the stockholders.

Request No. 55."——

The Court: Before you proceed, am I correct in my recollection of the evidence that since Sep-

tember 18, 1946 [562] the sole stockholders in United have been the defendant Sperling and Title Insurance and Trust Company as trustee?

Mr. Levy: Yes, your Honor; that is the evidence.

“Request No. 55. Since September 18, 1946, the persons who have been officers of United were selected solely by Sperling.

A. Not true. The officers have at all times since September 18, 1946 been elected by the unanimous vote of the Board of Directors.

* * * * *

Request No. 58. Whether any literary property purchased by United or otherwise acquired by it should or would be abandoned and written off by United as worthless, was determined solely by [563] Sperling, since September 18, 1946.

A. True.

Request No. 59. Sub-paragraph 6 of paragraph Seventh (a) of the master contract provides as follows:

‘The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are incurred in connection with such production program, the company shall, weekly, on proper vouchers or billing from the Producer, reimburse the Producer for a sum equal to one-half of such obligations, * * *’

Since September 18, 1946, any and all contractual obligations incurred by United and any and all com-

mitments made by United which are referred to in the above quoted paragraph were determined to be so incurred and were determined to be so made, solely by Sperling.

A. True except for Warner budget approval with respect to each picture.

Request No. 60. Since September 18, 1946, [564] the amount of compensation to be paid to Sperling for services rendered by him to United was determined solely by Sperling.

A. True but said determination was subject to the provisions of the master contract.

Request No. 61. Since September 18, 1946, the compensation which United would agree to pay to its accountants, attorneys and all other persons in United's employ, was determined solely by Sperling.

A. True.

Request No. 62. Since September 18, 1946, the price of any item of property that United agreed to purchase or otherwise acquire was determined solely by Sperling. A. True.

Request No. 63. Whether a picture to be produced by United under the terms of the master contract as amended would be produced by United as an 'original' or as an 'additional' picture was determined solely by Sperling, since December 6, 1947.

A. True.

Request No. 64. Paragraph 5 of the amendment to the master contract, dated December 6, 1947 provides: [565]

'You agree that, prior to the commencement of the principal photography of any of the photoplays

hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay, as hereinbefore referred to.'

The time, namely the day upon which (prior to the commencement of principal photography) United should or would advise Warner as to whether a picture proposed to be produced by United would be an 'original' or an 'additional' picture, was determined solely by Sperling, since December 6, 1947. A. True." [566]

* * * * *

Request No. 66:

"Before December 6, 1947, Sperling told Harry Warner that he (Sperling) was unwilling to proceed with the production of the pictures which then remained unproduced.

"A. True only to the extend that this defendant told Harry Warner that in view of uncertain business conditions he was temporarily unwilling to proceed." * * * * * [567]

Request No. 69:

"On or before December 9, 1947, Sperling, acting on behalf of United, and Harry Warner and/or Jack Warner, acting on behalf of Warner, orally agreed on the substance of the terms of the amendment to the master contract, which amendment is dated December 9, 1947. "A. True." [568]

* * * * *

The Court: December 9?

Mr. Levy: December 9.

The Court: Or December 6?

Mr. Levy: No; December 9. That is a further amendment to the master contract with reference to the picture Pursued.

The Court: You are referring now to which request?

Mr. Levy: I am referring now to Request No. 69.

The Court: That refers to what exhibit?

Mr. Levy: That refers to Exhibit No. 5 in evidence.

The Court: So stipulated?

Mr. Williams: So stipulated, your Honor. [569]

* * * * *

Request No. 71:

"Before July 20, 1950, Sperling, acting on behalf of United, and Harry Warner and/or Jack Warner, acting on behalf of Warner, orally agreed on the substance of the terms of the amendment to the master contract, dated July 20, 1950.

"A. True except that said agreement is dated July 21, 1950."

* * * * *

Request No. 73: [570]

"Before August 12, 1952, Sperling, acting on behalf of United, and Harry Warner and/or Jack Warner, acting on behalf of Warner, orally agreed on the substance of the terms of the amendment to the master contract, which amendment is dated August 12, 1952. "A. True."

Request No. 74:

"During Bernhard's connection with United, he

received approximately \$44,000 as compensation for services rendered by him. "A. True."

Request No. 75:

"During Sperling's connection with United, he has received in excess of one-half million dollars as compensation for services rendered by him to United, and for expenses. "A. True."

This exhibit, if the court please, is dated April 2, 1953. It is verified by the defendant Milton Sperling on the 6th day of April, 1953, before a Vice Consul of the United States. [571]

* * * * *

(The document referred to, and marked Plaintiff's Exhibit 113, was received in evidence.)

* * * * *

The Court: You may proceed, if you desire——

Mr. Levy: Yes, your Honor.

The Court: ——with the reading of the deposition of Samuel Carlisle, Exhibit 113 in evidence.

Mr. Levy:

"Deposition of Samuel Carlisle, a Witness Called By and in Behalf of the Defendants, Taken Pursuant to Stipulation Dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 17th Day of May, 1951, Before Arnold Schubert, a Notary Public of the State of New York.

Appearances: Moss, Lyon & Dunn, Esqs., (310 West 7th Street, Los Angeles, California), Attorneys for the Plaintiff, By: Moroney, Ettinger & Pottish, Esqs., (271 Madison Avenue, New York, N. Y.) Sol Pottish, Esq., of Counsel. [575] Freston

& Files, Esqs., and Eugene D. Williams, Esq., (650 South Spring Street, Los Angeles 14, California) Attorneys for defendants Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, By: Eugene D. Williams, Esq., of Counsel and Friedman & Bareford, Esq., (11 West 42nd Street, New York, N. Y.) and Joseph D. Karp, Esq., By: Joseph D. Karp, Esq., of Counsel. [576]

* * * * *

SAMUEL CARLISLE

59 Stratford Road, Rockville Centre, New York, called as a witness by the defendants, being first duly sworn by Arnold Schubert, a Notary Public of the State of New York, testified as follows:

Direct Examination

Q. (By Mr. Williams): What is your business address, Mr. Carlisle?

A. 321 West 44th Street, New York.

Q. What is your occupation?

A. I am Controller and Assistant Treasurer of Warner Bros. Pictures, Inc.

Q. How long have you been in the employ of that company? A. 25 years.

Q. Have you been Controller at all times during that period? A. Yes.

Q. Have you also been Assistant Treasurer at all times during that period? A. Yes.

Q. Do you occupy any other office in Warner Bros. Pictures, Inc.?

A. I am a director of the company, a member of the Board of Directors. [577]

(Deposition of Samuel Carlisle.)

Q. How long have you been a member of the Board of Directors of the company?

A. Since 1934.

Q. And that is continuously up to and including the present time? A. That's right.

Q. Your office and place of business is at the headquarters of the company in New York City, is it? A. Yes.

Q. Has it been your custom throughout the years since you have been a director to regularly attend all meetings of the Board of Directors?

A. Yes, I have attended them regularly.

Q. Do you have any business connection other than your association with Warner Bros. Pictures, Inc.? A. None whatsoever.

Q. I desire to call your attention to a meeting of the Board of Directors of Warner Bros. Pictures, Inc., which was held on the 25th of September, 1945, and I ask you whether you were present at that meeting. A. Yes, I was.

* * * * * [578]

Q. (Continuing): That meeting was a meeting at which the resignation of Mr. Joseph Bernhard was submitted to the Board of Directors. Do you remember that?

A. He submitted his resignation, yes.

Q. At the time of the submission of the resignation, can you state whether there was or was not any statement made to the Board, or conversation among the members of the Board, as to the reason

(Deposition of Samuel Carlisle.)

why he was resigning from Warner Bros. Pictures, Inc.?

A. Yes, there was a question put by one of the members of the Board—I don't recall just which one it was—as to the reason, which was natural, and Mr. Albert Warner, who was Chairman of the meeting there, explained to him then about this U.S. Picture Company going to be organized.

Q. What did he say about it, as nearly as you can remember?

A. Well, he said that Milton Sperling was going to produce the pictures and they wanted to [579] have a business man in, and Joe Bernhard, with his wide experience in business, would make an ideal man for that job.

Q. Was that the substance of what was said with reference to what Bernhard was going to do, or the reason for his resignation at that time?

A. Yes, that was.

Q. Was there anything said at that time with reference to who Milton Sperling was?

A. Yes, the Major explained there that he was the son-in-law of H. M. Warner.

Q. Was anything said as to what his previous experience had been?

A. Yes. The Major gave some of his background.

Q. What, as nearly as you can remember?

A. He had produced several pictures successfully. I think he had been working for Fox for a number of years, 20th Century-Fox, that is.

Q. Now, have you, so far as you can remember

(Deposition of Samuel Carlisle.)

given the substance of what was said on both of those subjects at that time? A. Yes.

Q. Was there any dissent from the vote of the directors accepting the resignation?

A. No, there was none. [580]

Q. I now desire to call your attention to a meeting of the Board of Directors which was held just a few days later, on the 28th of September, 1945, and ask you whether you were present at that meeting? A. Yes, I was.

Q. I call your attention to the fact that at that meeting there was something that came up with reference to a contract between United States Pictures Inc., and Warner Bros. Pictures, Inc. Do you remember that occasion?

A. Yes. Major Warner introduced the matter and gave a little explanation, the same as he had done at the previous meeting, and turned it over to Stanleigh Friedman to explain the deal.

Q. Can you remember the substance of what Mr. Albert Warner said at that time, when he brought up the subject of this contract?

A. Well, it was somewhat the same as he had mentioned before.

Q. Well, just give us the substance of it, as well as you can.

A. That Milton Sperling had been a successful producer and that Joe Bernhard was going in with him because of his wide experience, and they [581] would make pictures to be distributed through Warner Bros. Pictures and its subsidiary companies.

(Deposition of Samuel Carlisle.)

Q. What was the substance of the statement made by Mr. Friedman at that time?

A. He had a synopsis of the contract before him there, and he read it off to the meeting there, stating the various terms of distribution and overhead being charged and the use of the Warner Brothers' facilities at the studio.

Q. Now, strain your memory and tell us, as nearly as you can remember, the substance of what he said about the various terms of that contract.

A. Well, they were to use various facilities at the studio, and the overhead was to be charged to them on the basis of a survey that had been made by Price, Waterhouse & Company prior to that time, and the distribution was substantially the same as in other contracts that had been made with other producers: 20 per cent for distribution in the United States, 25 per cent for England, and various rates for other countries.

Q. Was anything said as to the financing or the cost of making the pictures?

A. The cost of pictures, Warner Brothers [582] was to put up half, and U.S. Pictures was to put up the other half. They might do it by borrowing money from a bank, and if so, we would make arrangements there to pay the money over to the bank—that is, U.S. Pictures' share.

Q. U.S. Pictures' share?

A. I did not state before that the contract also provided for splitting the receipts after the costs had been recouped.

(Deposition of Samuel Carlisle.)

Q. In what proportion were the receipts to be split? A. Fifty-fifty.

Q. That is your recollection of the substance of what Mr. Friedman stated to the directors at that time?

A. Yes. There may be some other details that he went into. He had the contract before him.

Q. Was the contract itself physically present at that time in the room?

A. Yes, it was.

Q. I think you said also that Mr. Friedman had a synopsis before him?

A. Had a synopsis.

Q. Do you remember any of the directors having asked Mr. Friedman or anybody else any [583] questions about this contract, or the persons involved?

A. Yes, I remember, I believe it was Mr. Catchings, Mr. Waddill Catchings—I am not certain, but I believe it was Mr. Catchings that asked the question about whether U.S. Pictures could make pictures for distribution elsewhere and make those pictures on the Warner lot, and Mr. Friedman told him no, they couldn't make them for distribution elsewhere, they had to be made somewhere else.

Q. Were there any other questions that you remember, any other discussion that you remember?

A. Well, there was a lot of discussion, but that was the only really important point, I think, that was brought out.

(Deposition of Samuel Carlisle.)

Q. Do you remember the substance of any of the other discussion that was had at that time?

A. No, I do not.

Q. After this matter had been presented to the Board, did the Board act favorably upon it?

A. The Board passed the resolution.

Q. Was there any dissenting vote?

A. None. [584]

Q. I take it, then, that you voted for this resolution, as well as the one concerning the resignation of Mr. Bernhard on the previous meeting?

A. I did. I voted for both.

Q. Either before or during, or at any of those meetings at any time, did Mr. H. M. Warner, or Albert Warner, or any other person, make any statement to you with reference to the manner in which you should vote on these resolutions?

A. No, no one ever did. At no time during my term as a director has anyone ever told me how to vote.

Q. Prior to the vote at the directors' meeting on the 28th of September, 1945, prior to going to that meeting, had you been informed as to the fact that negotiations were in progress concerning such a contract as this?

A. I am quite certain that I knew it.

Q. In your vote on these two matters, that is, the resignation of Mr. Bernhard and the execution of this contract, did you exercise your own judgment as to how you should vote?

A. I did, but we have to rely to a certain [585]

(Deposition of Samuel Carlisle.)

extent on the judgment of the executives in charge of these operations.

Q. In that regard, did you rely upon the judgment of those who had been negotiating this deal and Mr. Friedman, who explained it? Is that correct? A. Yes.

Q. Now I call your attention to the fact that there was a meeting of the Board of Directors of Warner Bros. Pictures, Inc. held on the 23rd of November, 1945, at which, according to the records of that meeting, you were present; do you remember being present at that time?

A. Yes, I was.

Q. That was a meeting which involved, among other things, the authorization or the ratification of a small change concerning the financing of pictures under this United States-Warner Brothers agreement. A. Yes, that's right.

Q. Was that matter explained at that meeting?

A. Yes, it was. [586]

Q. In connection with your vote, did any person suggest or request that you should vote any way on that matter? A. No.

Q. I call your attention to a meeting of the Board of Directors that was held on the 18th day of June, 1946, at which, according to the record, you were present, and I will say for your information, so that you may identify the meeting, this was a meeting at which, among other things, there was passed upon the matter of an amendment to the basic contract between Warner Bros. and United

(Deposition of Samuel Carlisle.)

States Pictures with reference to one play Pursued. Does that sufficiently identify the meeting for you? A. Yes.

Q. You were present at that meeting?

A. I was present.

Q. Prior to the meeting had you had some knowledge of the subject of this picture Pursued?

A. Yes, I did. The lawyers had spoken about it.

Q. State what your knowledge on the subject of this amendment concerning the picture Pursued was at the time of the meeting.

A. My recollection is that they wanted to get Teresa Wright to play in that picture Pursued, and the [587] only way they could get her in was on a sharing agreement. They organized this Hemisphere Corporation, and they had to amend that contract. It changed our percentage of the overhead upward, and it changed our percentage of the distribution upward from 20 to 25, of which we retained two and a half, and U.S. Pictures got the other two and a half.

Q. Was there any change made in the amount of the net profit—the distribution of the amount of the net profit?

A. Yes. Instead of the fifty-fifty, it was changed to one-third to Warner Bros. and one-third to United States Pictures.

Q. Now, had you, prior to this meeting of June 18th, knowing of these facts, given any consideration to what effect that would have on the amount of profit that might be gained by Warner Bros.,

(Deposition of Samuel Carlisle.)

assuming the picture had a normal distribution?

A. Yes. I worked up some figures, or had them worked up by some of my assistants here, assuming in one case that the picture grossed two and a half million, and in another case if it grossed three million.

Q. And what was, in round figures, the result of your computation in that regard? [588]

A. I have the statements here. On the three million basis, it showed that Warner's share would be \$362,500, on the old basis, and on the new basis it would be \$308,166. That is the producer's share to Warner Bros. Pictures, Inc; that doesn't take into consideration the increase in the distribution, which would be—I am wrong, it does take it in.

Q. You also figured it on a two and a half million gross basis, did you not?

A. Yes, we figured it on that basis.

Q. Was anything said to you as to the reason why it was advisable or necessary to make a deal with—what amounted to a three-way deal with a corporation known as Hemisphere Pictures, and United States Pictures, and Warner Bros. Pictures in regard to this particular picture?

A. Well, we were given to understand that that was the only basis on which they could get Teresa Wright in the picture, and I think Niven Busch—I think he had the story.

Q. Well, Niven Busch is a writer?

A. Yes.

(Deposition of Samuel Carlisle.)

Q. And Teresa Wright, is she a well-known motion picture star? A. Yes. [589]

Q. At any rate, you had that information and had checked up and had made the compilations of figures on the assumption that the picture would gross either two and a half or three million dollars before the meeting of the directors was held on June 18th, had you?

A. Yes—June 18th?

Q. Yes.

A. It must have been before that. I have no date on my—

Q. Well, now, let us get to the meeting of June 18th and perhaps that will refresh your recollection. Do you remember this matter being brought up before the directors on June 18, 1946?

A. Yes.

Q. Who presented the matter to the Board?

A. That was Mr. Friedman.

Q. Did he make a statement with reference to the matter at that time?

A. He did. Now, I do not recall definitely whether he presented these figures to the meeting.

Q. Well, let me ask you this: Do you remember that he did make a statement with reference to the conditions to be attached to this picture, to the making of this picture? A. Yes. [590]

Q. Do you remember the substance of what he said?

A. He explained to the Board there that while we got the lower share of the net profits of the

(Deposition of Samuel Carlisle.)

picture, we also got a higher share in the distribution and also a higher overhead, and there was also an allowance of \$50,000 additional, which was provided in that contract that we got before the split.

Q. Was there anything said——

A. I say we got—that is, split between U. S. Pictures and Warner Bros. Pictures.

Q. Was there anything said at that time on the subject of whether Niven Busch would permit the story to be used or whether Teresa Wright would act in the picture on any terms other than this?

A. No. We were given to understand that that was the only conditions.

Q. Do you remember whether Mr. Friedman or you or somebody else presented to the Board the compilations which you had theretofore made?

A. No, I do not recall these figures being submitted to the Board. They may have been, but I do not recall.

Q. You just don't remember with reference to the matter one way or the other?

A. That's right. [591]

Q. When the vote was taken, did you vote favorably to this resolution? A. I did.

Q. At that time, or at any prior time, had any person made a statement to you with reference to which way you should vote on the matter?

A. No one ever suggested it.

Q. And your vote, when you did vote, was the exercise of your own judgment as to the propriety of the action, was it? A. Yes.

(Deposition of Samuel Carlisle.)

* * * * * [592]

Q. (By Mr. Williams): Now, Mr. Carlisle, you have examined this contract of December 6, 1947, which I have described, and I ask you whether on or about, or shortly after the date of this contract, the fact of it having been executed on behalf of Warner Bros, was brought to your attention as Controller of the company?

A. Yes, a copy of it was sent to me about the latter part of December, 1947.

Q. Thereafter did you take any action with reference [593] to having the auditing and accounting division of the company——

A. Yes, in the ordinary course the copy was passed through so as to set up the records there to furnish all the statements, et cetera.

Q. Did you observe as to what the terms in general of this contract of December 6, 1947, were?

A. In general it provided for making an additional four pictures on different terms. The overhead was to be charged on the same basis as we charge all other pictures at the studio produced for our own use. The split of the profits after we had recouped our cost was increased from 50 to 80 per cent for Warner Bros. and reduced from 50 to 20 per cent for U.S. Pictures. I do not recall if there were any other changes.

Q. Do you remember if there was any change with reference to the distribution fee?

A. Yes. That was changed from 20 to 25 per cent.

(Deposition of Samuel Carlisle.)

Q. That was for domestic distribution?

A. For domestic, and the foreign was upped also. I don't recall just now.

Q. Do you remember whether there was any change with reference to the cost of production of the pictures?

A. The cost of production was to be entirely financed by Warner Bros. Pictures. [594]

Q. Whereas, under the previous one, it was fifty per cent? A. Fifty-fifty.

Q. You then became aware of those changes through reading a copy of this contract, which was sent to you at about the time the contract was executed? A. Yes.

Q. I call your attention, Mr. Carlisle, to a meeting of the Board of Directors of Warner Bros. Pictures, Inc., held on the 17th of August, 1950, at which, according to the record of the meeting, you were present, and which considered, among other things, the matter of the contract between United States Pictures and Warner Brothers. Do you remember having been present at that meeting?

A. Yes, I do.

Q. I will ask you whether, in the meantime and shortly before that meeting, there had been brought to your attention the fact that it was contemplated that there should be another amendment to the basic United States Pictures-Warner Bros. contract providing for additional pictures?

A. I had heard that, yes.

Q. At the time of the meeting of the 17th of

(Deposition of Samuel Carlisle.)

August, 1950, at the meeting of the directors, did any [595] person bring that matter up before the directors?

A. Yes, I believe it was Mr. Bareford, Harold S. Bareford.

Q. Mr. Bareford is not a director of the company, is he?

A. Not of Warner Bros. Pictures, Inc.

Q. But he was present at the meeting?

A. He was present at the meeting. He usually is present.

Q. And he is one of the attorneys for Warner Bros. and also an Assistant Secretary?

A. He is an Assistant Secretary.

Q. Will you state what, in substance, Mr. Bareford stated to the Board at that time with reference to this second amendment to the basic agreement?

A. Under the basic agreement, three pictures had been produced, and there were three more to be produced. This provided for an extension—I don't recall what the extended time was—an extension on producing those three pictures, and it also provided for making three additional pictures.

Q. The original contract, as you say, called for six pictures? A. Yes.

Q. The first amendment called for four additional pictures? A. Four additional.

Q. Did this amendment provide for three additional pictures in addition to the four?

A. Yes.

Q. Making altogether 13 pictures?

(Deposition of Samuel Carlisle.)

A. 13 pictures.

Q. Did Mr. Bareford state that to the directors?

A. Yes, he did.

Q. What did he state with reference to the conditions under which the other three pictures were meant to be produced?

A. I don't just recall now what he said. I believe those three pictures there were to be on the same basis as the others, as in the four pictures.

Q. I show you a copy of the minutes of the special meeting of Warner Bros. Pictures, Inc., held on the 17th of August, 1950, and ask you to examine so much of it as is necessary to refresh your mind, and particularly the last page which [597] refers to this matter.

A. Yes, all to be produced prior to January 1, 1953.

Q. By refreshing your recollection, you now remember more of the details of that matter as it was brought before the Board of Directors?

A. Yes.

Q. Have you examined the minutes?

A. Yes."

May I pause at this point, your Honor, to say that the minutes of the meeting of August 17, 1950 are in evidence in this case as Exhibit No. 23?

The Court: So stipulated?

Mr. Williams: So stipulated, your Honor.

Mr. Levy: "Q. Have you examined the minutes?

A. Yes.

(Deposition of Samuel Carlisle.)

Q. Did they appear to be correct minutes of that meeting as you recollect it? A. Yes.

Q. In so far as it refers to this matter?

A. Yes, that's right. [598]

Mr. Williams: May we have this copy of those minutes attached to the deposition, marked as Defendants' Exhibit No. 1 for identification in connection with the deposition?

Mr. Pottish: No objection.

Mr. Williams: And the only portion of the minutes which I am really interested in is the portion showing who was present and the portion of the last page of the minutes which shows the action with reference to the United States Pictures-Warners contract."

The reporter's note proceeds, in parentheses, as follows:

"Copy of minutes of meeting of Board of Directors of Warner Bros. Pictures, Inc., held on the 17th of August, 1950, was marked Defendants' Exhibit 1 for identification.)"

Mr. Williams proceeds as follows:

"Q. (By Mr. Williams): Mr. Carlisle, was a vote taken on this matter? A. Yes.

Q. Did the directors vote to approve the contract? A. They did. [599]

Q. You, yourself, I take it, voted in the affirmative? A. Yes, I did.

Q. Did any person, either before or during that meeting, at that time say to you in what way you should vote on that matter? A. No.

(Deposition of Samuel Carlisle.)

Q. When you voted, did you do so in the exercise of your independent judgment as to how the matter should be voted?

A. Yes, I did.

Q. Mr. Carlisle, in the number of years that you have been a director of Warner Brothers, has either Albert or Harry or Jack Warner, or any other person purporting to speak for them, directed you as to how you should vote on any matter which came before you as a member of the Board of Directors?

A. No, no one has either directed me or even suggested to me.

Q. That includes all of these matters involved in the United States Pictures deal?

A. Yes, it does. * * * * * [600]

Cross Examination

Q. (By Mr. Pottish): Referring to that meeting of September 25, 1945, you told us that Major Warner announced the resignation of Mr. Bernhard. A. Yes.

Q. Was it also Major Warner at that meeting who stated the reasons to the meeting for Mr. Bernhard's resignation, and stated the background of Mr. Sperling? [601] A. Yes.

Q. Did you have any independent knowledge, besides Major Warner's statement of Mr. Bernhard's reasons for his resignation?

A. No, that's all. * * * * * [602]

Q. In any event, did you cause any independent

(Deposition of Samuel Carlisle.)

investigation to be made concerning Mr. Sperling's background or experience prior to that meeting of September 25th?

A. No. As I say, we rely on the judgment of the executives in charge of that particular end of the business.

Q. Yes, you stated that, and when you say you relied on the executives in charge of that branch, to whom specifically do you refer?

A. Jack Warner is in charge of production, and H. M. Warner is in charge of everything—he is the President of the company.

Q. Of what?

A. Of everything; he is President of the company.

Q. So you relied principally on the recommendations of Jack and H. M. Warner in these connections concerning Mr. Sperling?

A. And what I had seen in trade papers occasionally. * * * * * [603]

Q. Did Major Warner, in announcing these facts on that meeting of September 25th, state that he thought Mr. Bernhard going with Mr. Sperling would be a good combination?

A. That is my recollection. * * * * *

Q. Did Major Warner say that the Bernhard-Sperling combination would be of any benefit to Warner Brothers?

A. He might have said so as an independent producer, producing pictures for Warner Brothers.

Q. Was it stated at that meeting of September

(Deposition of Samuel Carlisle.)

25th that the combination of Sperling and Bernhard would become independent producers of pictures for Warner Brothers?

A. At the meeting of the 25th?

Q. Yes. [604]

A. Well, I believe it was stated that that was what they had in mind.

Q. And this was all stated by Major Warner?

A. Yes.

Q. Well, coming forward to the meeting of September 28, 1945, in which you say the contract between United States Pictures and Warner Brothers was approved——

A. Yes.

Q. I believe you testified that Major Warner gave some explanation of the deal, and then Mr. Friedman gave the balance of the explanation of the deal.

A. Yes.

Q. Prior to that meeting had you seen a draft of the contract which was being approved?

A. No, I don't think I had, sir.

Q. And did you in a great measure rely upon the recommendations of Major Warner and Mr. Friedman in connection with the vote at that meeting on that contract.

A. We accepted their explanation of the contract. * * * * * [605]

Q. Do you recall whether at that meeting the contract itself was passed around to all directors present for examination?

A. I am pretty certain it was not.

(Deposition of Samuel Carlisle.)

Q. Was it mentioned at that meeting that Milton Sperling was the son-in-law of Mr. Warner?

A. Yes. While I said that I am pretty certain the contract was not passed around, the contract was always on the table available for anyone who wished to look at it. That is the usual procedure.

Q. You say the explanation of the contract at the meeting was provided by both Major Warner and Mr. Friedman?

A. The Major just told in very general terms what the deal was there and turned it over to Stanleigh Friedman to explain the contract.

Q. And did you rely in a great measure on the explanation, on the introductory statement made by Major Warner and the subsequent more detailed explanation given by Mr. Friedman?

A. Yes. * * * * * [610]

Q. Do you recall who made the recommendation at the meeting of September 25, 1945, regarding Bernhard's resignation and his going into business with Sperling?

A. That would be Major Warner.

Q. Was it also Major Warner that made the recommendation at the meeting of September 28, 1945, regarding the approval of the contract with U.S. Pictures?

A. Yes.

Q. Am I correct in assuming that Major Warner is Mr. Albert Warner?

A. Albert Warner, Vice-President and Treasurer.

Q. Let us go on to the contract of December 6,

(Deposition of Samuel Carlisle.)

1947. Do I understand correctly that there was no meeting of the Board of Directors to approve or disapprove this contract?

A. Apparently it was not approved.

Q. It was simply made by the officers of the company? A. Yes.

Q. And you thereafter saw a copy of that contract?

A. Yes, I received it in the same month in which the contract was drawn. [617]

Q. You received it the latter part of December, as I recall your testimony.

A. The 26th of December, to be exact.

Q. You had no say in whether or not that contract should or should not have been made prior to its execution? A. No.

Q. Coming down to the directors' meeting of August 17, 1950, at which you testified the directors passed on a further amendment to the basic agreement. Do you have any independent recollection or any notes which indicate to you whether or not you saw a copy of that proposed amendment prior to that directors' meeting?

A. I have no notes, but I had heard it in discussion amongst ourselves. [618]

Q. At the meeting, who presented that amendment? I withdraw that.

I have here a record that Mr. Bareford——

A. Mr. Bareford explained it.

Q. Explained the amendment at the meeting?

A. Yes.

(Deposition of Samuel Carlisle.)

Q. Did he make a recommendation with regard to it? A. No, I don't think so.

Q. Was there any executive of the company that made a recommendation regarding that amendment at that meeting?

A. I would assume that Major Warner recommended it as being the opinion of the studio executives.

Q. He is in charge of that phase of it, Major Warner?

A. No, he is the Treasurer. Jack Warner is in charge of the studio, but he is very seldom at our meetings.

Q. Did you rely to some measure upon the recommendations of Major Warner and upon the explanation of the amendment as made by Mr. Bareford before arriving at your vote?

A. Yes. Major Warner generally passes [619] along to us the opinions of his brothers as to the collective opinion.

Q. He represents his brothers at the meetings?

A. Yes.

Q. In that way, all the brothers do not have to be present at the meetings?

A. Well, it isn't for that reason they stay away. They are out on the Coast.

Q. Well, these meetings were held in New York?

A. They were held in New York.

Q. And Major Warner was the Warner brother that was here at those meetings?

A. His headquarters are in this office.

(Deposition of Samuel Carlisle.)

Q. When he makes these recommendations, he makes it understood that he is speaking for the three Warner brothers?

A. Well, we all accept it that way.

Q. Did you, prior to approving the amendment agreement of August 17th that was presented at the meeting of August 17, 1950, investigate whether at that time the distribution percentage to the Warner Bros., distribution Company was a fair one?

A. Yes. I didn't investigate; just from general knowledge. [620]

Q. Are you familiar with the records of the distribution company? Does that come within your jurisdiction as Controller? A. Yes.

Q. Do you know whether they were making a profit under that distribution fee of 20 per cent?

A. It is very hard to say whether you are making a profit on an individual picture. We have our branches all throughout the country, and the overhead runs on whether you have 15 pictures or 20 pictures; so that the more pictures you have, the lower the overhead is on all of them.

Q. Well, did you have prepared for yourself any analysis which would allocate to these pictures being produced by United States Pictures a percentage of the total overhead of the distribution corporation so that you could figure out whether the distribution corporation was making a profit on this distribution contract?

A. The distribution company for a number of years has made a profit on the 20 per cent that we

(Deposition of Samuel Carlisle.)

allow them for distributing Warner Brothers pictures and all other pictures.

Q. And no other pictures?

A. All other pictures.

Q. And all other pictures? [621]

A. Yes.

Q. Did you ever investigate as to whether they would, after analysis, be making a profit only with respect to the United States Pictures' pictures?

A. There was no way of finding that out.

Q. Well, isn't there a way of allocating the United States Pictures' overhead as against the rest of their overhead?

A. You can do so, but it isn't quite satisfactory. You still have that overhead running on.

Q. At whose instance were you elected a director of this company, Mr. Carlisle?

A. Mr. Warner.

Q. Which Warner?

A. H. M. Warner.

Q. I take it that as annual elections of directors take place, why, the directors are nominated by a group, a committee?

A. It is generally Mr. Warner there that is asked if he wishes to make any changes.

Q. And he, in effect, controls the naming of the Board of Directors, does he not?

A. That is, those inside the organization.

Q. Yes. And you are mindful of that?

A. Yes. [622]

Q. Mr. Warner and his two brothers in effect

(Deposition of Samuel Carlisle.)

control, do they not, whether or not you shall stay on as Controller or Assistant Treasurer of the company? A. Certainly. * * * * *

Q. Did you exercise any surveillance over the administration of the contract between Warner Brothers and United States Pictures regarding the amount of overhead charges which were being charged by United States Pictures?

A. That is done at the Coast.

Q. You exercised no surveillance on that?

A. No.

Q. You were unaware at the time you voted for the amendment in August of 1950, as to how that portion of the contract was being administered.

A. Well, I do know that they watch it closely and check up on it. [623]

Q. Yes, but you personally have no knowledge of that administration? A. No."

* * * * * [624]

Mr. Levy: I will call Mr. Roy Obringer.

ROY JOHN OBRINGER

called as a witness on behalf of the plaintiff, having been first duly sworn, testified as follows:

The Clerk: Will you state your name to the court?

The Witness: Roy John Obringer.

Direct Examination

Q. (By Mr. Levy): Mr. Obringer, are you the Obringer who signed and who verified the inter-

(Testimony of Roy John Obringer.)

rogatories addressed to Warner Bros., copies of which I will show you in evidence in this case as Exhibits 104-A and 107? A. Yes, sir.

Q. You are Assistant Secretary of Warner Bros. Pictures, Inc.? A. I am.

Q. Are you an employee of Warner Bros?

A. Yes, I am. * * * * * [626]

Q. What are you duties, generally?

A. I am the resident attorney of Warner Bros. Pictures, Inc., at its studio at Burbank, California, having administration of the contract department.
* * * * * [627]

Q. (By Mr. Levy): Mr. Obringer, you were asked the following question——

Mr. Williams: What page?

Q. (By Mr. Levy): I am referring now to page 2 of Exhibit 107, subdivision “(h) State the dates and amounts of cash loans or advances (if any) made by Warner to United in connection with the production of said picture;”

And your answer was: “None; however, Warner made cash loans for general purposes as follows: September 11, 1945, \$50,000; February 15, 1946, \$100,000.” [634]

I ask you, Mr. Obringer, what you meant by the words “general purposes” in your answer?

A. The figures which you have quoted were obtained by me from the accounting department. And, may I see the question, please?

Mr. Levy: Yes.

The Court: The clerk will place the original ex-

(Testimony of Roy John Obringer.)

hibit before the witness. What is its number, 107?

Mr. Levy: 107, your Honor.

The Court: Interrogatories, is it not?

Mr. Levy: Interrogatories, yes, your Honor.

The Witness: I am unable to answer the question. * * * * * [635]

Q. Does your answer hold good with respect to the \$100,000 loan? A. It does.

* * * * * [636]

Mr. Levy: May I at this time, your Honor, read into the record the deposition of the plaintiff Edward S. Birn? It is Exhibit 22 in evidence.

The Court: You may. Exhibit 22?

* * * * * [657]

DEPOSITION OF EDWARD S. BIRN

Mr. Levy: "Deposition of Plaintiff Edward S. Birn taken at the office of Moroney, Ettinger & Pottish, 271 Madison Avenue, New York, New York, on May 21, 1951, at 10:30 a.m. pursuant to stipulation made among the attorneys for the respective parties dated May 2, 1951.

"Present: Edward S. Birn, Plaintiff. Sol Pottish, Esq., of Moroney, Ettinger & Pottish, 271 Madison Avenue, New York, attorneys of counsel for Moss, Lyon & Dunn of 210 West 7th Street, Los Angeles 14, California, attorneys for the plaintiff. Eugene D. Williams, Esq., of counsel for Freston & Files and Eugene D. Williams of 650 South Spring Street, Los Angeles, 14, California, attor-

(Deposition of Edward S. Birn.)

neys for defendants Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, Joseph D. Karp, Esq. of Friedman & Bareford of 11 West 42nd Street, New York, New York, of counsel for [658] defendants Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner. * * * * *

“The plaintiff, being first duly sworn, testified as follows:

Q. (By Mr. Pottish): Mr. Birn, at the time of the commencement of this suit in 1948, were you the owner of 400 shares of stock of Warner Bros. Pictures, Inc.? A. I was.

Q. Had you continuously been the owner of those shares of stock since August 21, 1944?

A. I have been continuously the owner of these 400 shares but I sold 200 shares about the early part [659] of May, 1951.

Q. So that at this time you are the owner of the 200 of the original 400 shares? A. Yes.

Q. Do you recall bringing a law suit in the State of California on behalf of the stockholders of Warner Bros. Pictures, Inc. against the officers and directors for a claim of wrongdoing on their part in connection with certain contracts and dealings between Warner Bros. Pictures Inc. and United States Pictures Inc.?

A. I do. I believe our suit was started in December 1948.

Q. Do you recall the transactions complained about in that law suit had their inception in a contract made between Warner Bros. Pictures Inc.

(Deposition of Edward S. Birn.)

and the United States Pictures Inc. in September 1945?

A. In 1948 I found out the facts but in 1945 I did not know them. * * * * * [660]

Q. When did you first learn of that contract or of any dealings between United States Pictures Inc. and Warner Bros. Pictures Inc.?

A. In late September or early October in 1948, I overheard a conversation in a broker's office that Warner Bros. was being sued for some very large sums of money. I injected myself in this conversation but was not able to get all the facts. I then contacted Harry Ettinger who I have known for many years and asked him whether he would investigate and see whether there was anything to it. * * * * * [661]

Q. As a result of that conference with Mr. Ettinger, did you authorize the bringing of a law suit against United States Pictures Inc. and the directors and officers of Warner Bros. Pictures?

A. I did." [662]

"Q. And subsequently after that suit was brought in New York, did you authorize an additional suit to be brought in California?

"A. Mr. Ettinger explained to me that he could not serve the directors in New York and thought it would be necessary to bring a suit in California and I authorized him to do it.

"Q. Did you from time to time receive Proxy Statements and Notices of Meetings of Warner Bros. Pictures, Inc.?

(Deposition of Edward S. Birn.)

"A. I receive Proxy Statements from Warner Bros. and many others every day.

* * * * * [663]

"By Mr. Williams: What is your full name?

"A. Edward S. Birn. * * * * *

"Q. You are in the stock market as a business?

"A. No, sir.

"Q. And your purchase of Warner Bros. stock was a private investment of your own?

"A. That is right. * * * * * [664]

"Q. How many years have you been a stockholder?

"A. I have owned Warner Bros. stock fifteen to twenty years back to 1929.

"Q. During that time every year you have received, have you not, notice of Stockholders Annual Meeting and also Proxy Statement and Financial Statement from the company?

"A. I get them every day from Warner Bros. and many other companies.

"Q. Specifically from Warner Bros., a proxy statement, a proxy, a financial statement and a notice of stockholders meeting each year you have been an owner?

"A. I guess I did.

"Q. When you say you guess you did, you would not say that you did not receive them?

"A. I am sure they didn't single me out to omit me. * * * * * [665]

"Q. Mr. Birn, I show you a proxy which appears to be addressed to Edward S. Birn, 1450 Broad-

(Deposition of Edward S. Birn.)

way, which bears date January 14, 1946, and appears to be signed Edward S. Birn. I will ask you to state whether the writing January 14th and Edward S. Birn were written by you? [667]

“A. That is my signature. * * * * *

“Q. I also have a proxy addressed to Edward S. Birn, 1450 Broadway, New York City, which appears to have been dated in ink, January 23, 1947, and was signed Edward S. Birn in ink. I ask you whether you put in the ink date January 23 and the name Edward S. Birn in that proxy.

“A. That is my signature, the same as the other.

“Q. And you undoubtedly signed that proxy to Warner Bros.?

“A. Yes, I as a rule sign the proxy and save the company the expense of sending me a duplicate or a second request. * * * * *[668]

“Q. And do you expect personally to gain anything from the case other than your participation as a stockholder in the benefits to be received by the corporation, if any?

“A. No. I own too many stocks and have been hurt too often by unethical practices of directors and officers.

“Q. Do you have any agreement with Mr. Ettinger or his firm to the effect that you will participate in any fee which may be allowed by the court in case this action may be successful?

“A. I do not.

“Q. Do you anticipate or expect to gain any

(Deposition of Edward S. Birn.)

[670] advantage of any kind whatsoever other than the advantage that any stockholder may gain from whatever judgment might be derived in this lawsuit for the benefit of the corporation?

“A. I do not. * * * * *

“By Mr. Pottish: Q. When you authorized Mr. Ettinger to bring this lawsuit, did you authorize him to take any steps necessary to prosecute this case successfully?

“A. I did.

“Q. It is my understanding, Mr. Birn, that you told me that you had agreed with Mr. Ettinger by way of a gentleman's agreement that if he were unsuccessful in this lawsuit that you will figure out some reasonable compensation for the time he spent. Did you agree to such compensation?

“A. I did.

“Q. When you answered Mr. Williams a little while ago, you stated the only fee was to reimburse him for his expenses. [671]

“A. I overlooked that. Mr. Ettinger said it would be a reasonable fee and we would sit down and discuss it.

“Q. I show you Exhibit D, being proxy dated January 14, 1946, and ask you whether if at the time that proxy was before you for signature you knew about the claimed unethical and wrongful acts which you have alleged in your complaint, whether you would have signed this proxy and ratified the acts of the directors?

“A. Certainly I would not.”

* * * * * [672]

Signed “Edward S. Birn.”

“Sworn to before me this 12th day of June, 1951.

“Benjamin L. Hoch, Notary Public.

* * * * * [674]

Mr. Williams: If your Honor please, may I at this time offer into evidence the various documents which have [675] been identified as attached to the depositions as Exhibits A, B, C, D, and E?

The Court: Aren't they in evidence as part of the deposition?

Mr. Williams: Yes.

Mr. Levy: They are, and if they are not, I have no objection to the offer that is made.

The Court: I just want the record to be clear. I made an announcement on the record the other day that, in the absence of any objection or any exceptions to it, whenever any writing is offered in evidence which has some attachments to it, that the attachments will be deemed in evidence with the writing and bear the same identification in the record here under a sub-numbering or sub-lettering as they bear originally in the exhibit. For instance, Exhibit A to the Birn deposition would be in effect 22-A here in the record.

Mr. Williams: As long as there is no misunderstanding on it. I just wanted to be sure that the documents were in evidence.

And may I at this time, if it is convenient, call the court's attention to the fact that the Proxy Statement which is Exhibit A attached to the depo-

sition of Edward S. Birn which has just been read, on page 3 of that Proxy Statement there is a statement with reference to this transaction which is involved in this case. Would it be of convenience [676] to the court if I read it at this time, just one paragraph dealing with this transaction?

The Court: Yes.

Mr. Williams: It is headed "Transactions Between the Corporation and Directors.

"On September 28, 1945 this Corporation entered into an agreement with United States Pictures, Inc., of which Joseph Bernhard is President and owner of 50% of the stock, for the production of six feature motion pictures for distribution by this Corporation. Warner Bros. Pictures, Inc. does not own any of the capital stock of United States Pictures, Inc. The agreement provides generally as follows. The motion pictures are to be produced at the studios of this Corporation and this Corporation agrees to advance 50% of the cost of production of each motion picture by either cash, charges for talent and facilities furnished for the production of the motion pictures, or proportional charges for overhead of studios, etc. Subsidiaries of this Corporation will distribute the pictures throughout the world and retain from the gross proceeds certain direct expenses and certain percentages of the gross receipts of distribution which vary for different countries. United States Pictures, Inc. is required to provide [677] the other 50% of the cost of production of each of the motion pictures, and may borrow this and pledge as security therefor

the negatives, positive prints and all of the net proceeds of distribution after the deductions above referred to.

“On November 2, 1945, a loan agreement was entered into between The New York Trust Company, as lender, United States Pictures, Inc., as borrower, and this Corporation, for such part of the cost of production as may be borrowed by United States Pictures, Inc., which agreement provides for the pledge of the security referred to in the preceding paragraph. After such loans shall have been repaid and Warner Bros. Pictures, Inc. has been reimbursed for the amounts advanced by it, and then United States Pictures, Inc. has been reimbursed for the balance of the amounts advanced by it, then Warner Bros. Pictures, Inc. and United States Pictures, Inc. shall share equally in the remaining net proceeds of distribution.”

* * * * * [678]

(Plaintiff's Exhibits 37-A to 37-G, inclusive, for identification were received in evidence.)

Mr. Williams: If your Honor please, I may be in error, but I understood that the court was limiting the evidence at this time to the question of the applicability of the statute of limitations, and the matter that counsel just referred to obviously has nothing to do with that subject.

It doesn't make any difference to us personally whether we do or do not limit the evidence.

I just want to know where we stand on that subject.

Of course, your Honor, we anticipated and hoped for a judgment that would involve the merits of this case, but your Honor has very properly suggested that the matter might be disposed of on the applicability of the statute of limitations, and I understood at this time we were addressing ourselves to that one issue.

The Court: I want to try that issue first. The first issue in this case, as it is in every case in the Federal Court, is one of jurisdiction.

* * * * * [681]

Mr. Levy: I offer in evidence Exhibit 36-A, presently marked for identification, that being the minutes of the annual meeting of the stockholders of Warner Bros. held on the 18th day of February, 1947. Incidentally, might I ask Mr. Williams, have you the minutes for 1946? [712]

Mr. Williams: I don't think so.

Mr. Levy: This is the first set of minutes that——

The Court: Do you expect to offer all those minutes listed on page 6 of Exhibit 102?

Mr. Levy: Yes.

The Court: Then you offer Exhibit 36-A, the 1947 minutes; Exhibit 36-B, the 1948 minutes; 36-C, the minutes of the 1949 meeting; 36-D, the minutes of the 1950 meeting of stockholders; Exhibit 36-E, the minutes of the 1951 meeting; 36-F, the minutes of the 1952 meeting; and Exhibit 36-G, the minutes of the 1953 meeting of stockholders?

Mr. Levy: Yes, your Honor.

The Court: Any objection?

Mr. Williams: Yes, We object to them on the grounds they are not competent, relevant, or material, do not prove or tend to prove any issue involved in this case.

The Court: The objection is overruled. They are received in evidence.

(Plaintiff's Exhibits 36-A to 36-G for identification were thereupon received in evidence.)

* * * * * [713]

The Court: Very well. Please mark it Exhibit 120 for identification, the deposition of John Bierworth. Do you offer it in evidence?

Mr. Levy: Yes, your Honor. * * * * *

(The document was thereupon marked Plaintiff's Exhibit 120 and received in evidence.)

* * * * * [717]

DEPOSITION OF JOHN BIERWORTH

"Examination of Mr. John Bierworth as witness pursuant to stipulation between attorneys for respective parties, dated August 30, 1950, and subsequent adjournments made under said stipulation. The examination was held at the office of Mr. Bierworth, at National Distillers Corp., 120 Broadway, New York, New York, on November 3, 1950 at 2:30 p.m.

"Present: Mr. John Bierworth, Witness, Stanleigh Friedman, Esq., attorney for Mr. Bierworth, Joseph D. Karp, Esq., attorney of counsel for Warner Bros. Pictures, Inc. Sol Pottish, Esq., attorney of counsel for plaintiff.

(Deposition of John Bierworth.)

The witness, being duly sworn, testified as follows:

* * * * *

Questions by Mr. Pottish: [718]

Q. Between what dates were you director of Warner Bros. Pictures, Inc.?

A. I still am. November 23, 1945 to date.

Q. During what period were you a director of New York Trust Company.

A. September 19, 1941 to date.

Q. During what period of time were you an officer of New York Trust Company and what was that office.

A. Vice President, from October, 1929 to September, 1941; President from that date to, I think, November 9, 1949.

Q. Do you know Harry Warner, Jack Warner and Albert Warner. A. Yes.

Q. Did you know them prior to the time you became a director of Warner Bros. Pictures, Inc.

A. Yes.

Q. Have you known Milton Sperling since the date of your directorship in Warner Bros. Pictures, Inc.

A. You mean since I became a director or prior to that time.

Q. Was it prior to the time you became director of Warner Bros. Pictures, Inc. that you became director of Warner Bros. Pictures, Inc. that you [719] knew him. A. I think so.

Q. Do you know him to be a son-in-law of Harry Warner? A. Yes.

(Deposition of John Bierworth.)

Q. Were any or all of the three Warner brothers instrumental in effecting your election as director of Warner Bros. Pictures, Inc.

A. I don't know.

Q. Do you know who nominated you to be a director.

A. I don't know.

Q. Who notified you of your election as director.

A. The Board of Directors.

Q. Prior to your notification did you not know you were being elected.

A. You don't call up someone and tell him you are a director without first someone calling you up to ask if you would serve if elected.

Q. In this case you were asked prior to your election to serve by Harry Warner.

A. That is right.

Q. Subsequent to your election as a director of Warner Bros. Pictures did you attend every meeting [720] of the directors.

A. No.

Q. Do you have any recollection or record of just which meetings you did or did not attend.

A. The minutes would show that. I do not know.

Q. In what manner did you keep yourself informed of the affairs of the corporation subsequent to your election.

A. You could ask that about any company but could not answer it. You talk to the officers—you go to as many meetings as you can.

Q. Were most of your discussions concerning the company's affairs had with either or all of the three Warner brothers.

(Deposition of John Bierworth.)

A. No. I would say they were more with the treasury end of the business. Possibly with Stuart McDonald more than anyone else.

Q. Who was Stuart McDonald.

A. Assistant Treasurer.

Q. Subsequent to your election did you learn of an agreement which had been made between Warner Bros. Picture and United States Pictures, dated September 28, 1945 which concerned production of motion pictures by United States Pictures, Inc. using Warner Bros. Pictures' facilities. [721]

A. I learned of it prior to my election. Whether or not I had seen the specific agreement I do not know but the loan negotiations with the New York Trust Company were based on the assumption that an agreement embodying the features as outlined would be signed between United States Pictures and Warner Bros. Pictures.

Q. When you speak of loan by New York Trust you are speaking of a loan agreement which was signed on October 31, 1945, the parties to which were New York Trust, Warner Bros. Pictures and United States Pictures.

A. I do not know the date of that agreement but I am referring to the only agreement I know of between the two.

Q. That refers to loan to be made to United States Pictures to finance their production of pictures under their agreement with Warner Bros. Pictures.

A. I assume that is so.

(Deposition of John Bierworth.)

Q. Did you have any part in the negotiations leading up to that agreement. A. Yes.

Q. In what capacity did you act?

A. As President of New York Trust Company.

Q. Did you participate as President of New York Trust Company in the negotiation of the agreement made October 31, 1945 between New York Trust Company, Warner Bros. Pictures, Inc. and United States Pictures, Inc.

A. What agreement is that.

Q. Roughly, that agreement referred to a loan to be made by New York Trust to United States Pictures for the purpose of helping United States Pictures produce pictures under its agreement with Warner Bros. Pictures. A. Yes.

Q. As President of New York Trust were you in charge of all loan negotiations with moving picture companies?

A. As President of New York Trust I was in charge of everything, I presume. Not necessarily specifically. I knew of all loans made, of course.

* * * * *

Q. Did you take a personal participation in this loan agreement with United States Pictures, Inc.

A. Yes. [723]

Q. Did you investigate into the propriety of the basic agreement between Warner Bros. Pictures and United States Pictures before you approved the loan to United States Pictures.

A. I don't think I know what you mean by the propriety of it.* * * * *

(Deposition of John Bierworth.)

Mr. Levy: "Q. Did you investigate into the reasonableness of the agreement before you approved the loan to United States Pictures?

Objection by Mr. Friedman as calling for conclusion.

Mr. Karp: Same objection. (Not answered.)

* * * * * [724]

Q. Mr. Bierworth, I am not referring to the loan agreement. I am referring to the agreement between Warner Bros. Pictures and United States Pictures which had to be executed as a condition to your making the loan to United States Pictures and I ask you with respect to that agreement whether or not you investigated into its terms and knew of them fully before you approved the loan to United States Pictures.

A. I do not think I could answer that. I do not think I know.

Q. Did you actually read over the agreement between United States Pictures and Warner Bros. Pictures before approving the loan to United States Pictures.

A. I would doubt it because the usual method on a loan of this type is to turn it over to your attorney who sees if the papers are drawn in accordance with [725] the understanding.

Q. In making the loan were you concerned with the relative advantages to either United States Pictures or Warner Bros. Pictures under their agreement between themselves.

A. No. * * * * *

Q. Subsequent to your election as director of

(Deposition of John Bierworth.)

Warner Bros. Pictures did you exercise any surveillance over the administration of the agreement between Warner Bros. Pictures and United States Pictures. A. No.

Q. Subsequent to your election did you make a study of the terms of the agreement existing between Warner Bros. Pictures and United States Pictures and the amendments thereto.

A. No.

Q. Are you familiar with the loan agreements outstanding between Warner Bros. Pictures as a borrower [726] and a series of institutions including New York Trust Company which evidenced a loan in the original total amount of \$15,000,000.

A. I was at the time, as I arranged the loans.

* * * * *

Q. Were you familiar with the provisions of the loan agreements between Warner Bros. Pictures and New York Trust Company and other banks.

Mr. Friedman: Same objection." [727]

Mr. Williams: We waive the objection.

Mr. Levy: "A. In general I was familiar but I do not remember details. They were always handled by our attorneys.

Q. Specifically do you recall whether there was any provision included in the loan agreement between New York Trust Company and Warner Bros. Pictures to the effect that without the consent of 75% of the holders of Warner Bros. Pictures' notes, Warner Bros. Pictures could not pledge any of its

(Deposition of John Bierworth.)

assets or moving pictures or moneys due under contracts.”

Mr. Williams: The objections are waived, your Honor.

Mr. Levy: “Mr. Karp objected to this as improper in form and also on the grounds of being incompetent, irrelevant and immaterial.

“Mr. Friedman: I object on all the grounds interposed and on the further ground that the document speaks for itself. You asked if he was aware of it and I say the document speaks for itself.

A. I do not recall specifically. I would have to refer to the agreement. If it was in there I would have known at the time—if not I would not have known of it. * * * * * [728]

Q. In this particular case, Mr. Bierworth, tell us in your own words what considerations were given the greatest weight by you prior to your approval of the loan to United States Pictures.

Mr. Friedman objected to this question based upon the fact that it calls for mental conclusions and not statements of fact and therefore is objectionable. Same objection by Mr. Karp.”

Mr. Williams: We add to it the objection that it does not prove or tend to prove any issue in this case. It does not make any difference what the reasons which actuated the officers of the New York Trust to make the loan. The question is not relevant to any issue involved here. They could have made it for any one of a thousand reasons.

Mr. Levy: Well, in answer to Mr. Williams may

(Deposition of John Bierworth.)

I say this, your Honor: That the question has this bearing upon the total issue which is, has been and will be placed before this court, namely, whether or not the Warner Bros. in this case were the control of this corporation in essence and in reality, irrespective of the forms that either the board of directors went through or any of the officers or employees went through.

The Court: Overruled. You may read the answer.

Mr. Williams: Your Honor, this man was not an officer or an employee or a director of Warner Bros. [731]

The Court: Overruled.

Mr. Levy: "A. I think they are right. I think it is impossible to recall 5 years ago what my conclusions were. I think I can tell you in general, if you want to know what anyone's reasoning is that lends money." * * * * *

Q. Did you know at that time that United States Pictures were being capitalized with a capital of \$25,000.

A. If that was a fact I assume we did.

Q. You also knew at that time, did you not, that the principal officer of United States Pictures were Messrs. Milton Sperling and Joseph Bernhard.

A. Yes.

Q. Did their credit standing play any part in the question of whether the loan should be approved to United States Pictures. [732]

A. I cannot recall.

(Deposition of John Bierworth.)

Q. Is it not a fact that the New York Trust Company also considered, prior to approving the loan, the fact that the loan would be repaid out of the proceeds of the motion pictures to be produced under the agreement between United States Pictures and Warner Bros. Pictures.

A. That is right.

Q. Would you say that principal consideration was given by you to the latter fact as the basis for extending the loan to United States Pictures—the latter fact referred to being the fact that the loan would be repayable out of the proceeds of the moving pictures to be produced.

A. Yes.

Q. Would you have agreed to make a loan agreement of that size with United States Pictures in the absence of Warner Bros. Pictures being a party to the agreement.

A. Yes.

Q. Do you recall who handled the negotiations for the loan agreement on behalf of United States Pictures.

A. Bernhard.

Q. Do you recall who handled the negotiations [733] for that loan on behalf of Warner Bros. Pictures.

A. No.

Q. That loan agreement to United States Pictures was not the only loan ever negotiated by you to a moving picture company.

A. No.

Q. Has it been customary or usual in your practice as president of the bank to extend loans to a moving picture company for the entire cost of production of a movie.

(Deposition of John Bierworth.)

Mr. Friedman objected to this as irrelevant, incompetent and not within the issues of this action as set forth in the complaint and answer.

Mr. Karp objected to this as improper in form.

Mr. Friedman instructed witness not to answer." And we proceed to the next question.

"Q. During the existence of the loan agreement, did you ever familiarize yourself either as president of the New York Trust Company or as director of Warner Bros. Pictures with the salary that Sperling was receiving in his connection with United States Pictures. A. No.

Q. Did you in those capacities ever investigate [734] or attempt to determine the manner in which the contract between United States Pictures and Warner Bros. Pictures was being administered.

A. No.

Q. At any time during the existence of the loan agreement did the bank attempt to regulate the amount of salaries or overhead being incurred by United States Pictures.

A. Not to the best of my knowledge.

Q. Is United States Pictures a depositor in New York Trust Company.

A. I do not know. * * * * * [735]

"Q. The same question as to Warner Bros. Pictures.

"A. Yes. They are and were a depositor.

"Q. The same question as to any of the three Warner brothers.

"Mr. Friedman objected to this on ground ques-

(Deposition of John Bierworth.)

tion is irrelevant, immaterial, and privileged and he moves to strike out the question and instructs the witness not to answer. Mr. Karp made the same objection."

Now, may it please the court, preceding Mr. Friedman's objection, that is to say, as the deposition exhibits the fact, in between the line on which the question is written and the line on which Mr. Friedman's objection is noted as aforesaid, the witness has apparently, before he signed and swore to this deposition, made the following answer, and this is written in ink:

"A. Banks don't give out confidential information."

I proceed with the reading of the next question:

"Q. As director of Warner Bros. Pictures, did you make any investigation to satisfy yourself whether or not in your opinion the agreement between Warner Bros. Pictures and United States Pictures was fair to Warner Bros. Pictures? [736]

"A. No.

"Q. Do I understand you correctly when I say that your testimony is that the loan agreement between New York Trust Company and United States Pictures, to which Warner Bros. Pictures was a party, was based upon and would not have been executed without the execution of the corollary agreement between Warner Bros. Pictures and United States Pictures for the production of movies?

"A. I think that you will find, if you refer to

(Deposition of John Bierworth.)

another question in which you asked me if I examined the credit of United States Pictures and would have made the loan without the Warner Bros. Pictures being party to the agreement, my answer was that I would. * * * * * [737]

It is signed "John E. Bierwirth.

"Witness.

And, "Sworn to before me this 30th day of November, 1950. Andrew A. Walls, Notary Public."
* * * * * [739]

Mr. Levy: I offer in evidence, your Honor, Exhibit 31 for identification, that being an agreement dated [761] August 31, 1945, between Joseph Bernhard and Milton Sperling. * * * * *

Mr. Levy: Yes, your Honor, a stockholders agreement between Bernhard and Sperling dated August 31, 1945. I offer that in evidence.

The Court: Any objection?

* * * * * [762]

Mr. Williams: It is objected to on behalf of the Warner defendants on the ground there is no foundation laid as to them. It has not been shown that it was called to their attention or that they were parties to the agreement or knew the contents thereof, and it is hearsay for that reason. * * * * *

The Court: The objection is overruled.

Exhibit 31 is received in evidence.

* * * * * [763]

DEPOSITION OF W. STEWART McDONALD

Plaintiff's Exhibit 114: Deposition of W. Stewart McDonald, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th Street, New York, N.Y. on the 18th day of May, 1951, at 11:30 a.m., before Arnold Schubert, a Notary Public of the State of New York. * * * * * [784]

W. Stewart McDonald, called as a witness in behalf of the defendants, being first duly sworn, testified as follows: * * * * *

Direct Examination

Q. (By Mr. Williams): Mr. McDonald, what is your place of residence? [784-1]

A. Scarsdale, New York.

Q. What is your occupation?

A. I am Assistant Treasurer of Warner Bros. Pictures, Inc. I am a Vice-President of various theatre subsidiaries, a director of most of such theatre subsidiaries, and also an Assistant Treasurer of the theatre subsidiaries.

Q. You have been employed by Warner Brothers or one of the subsidiaries, one or more of the subsidiaries, for what length of time?

A. Since January 1, 1931.

Q. Prior to that time did you have any connection with Warner Brothers?

A. Yes, I did. I was with Goldman, Sachs & Company, and ever since December 1927, I have followed the affairs of Warner Brothers.

(Deposition of W. Stewart McDonald.)

From December, 1927, until the time I joined Warner, I was one of Goldman, Sachs & Company's representatives who frequently visited this office.

Q. Since you joined Warner Brothers have you made it a practice to attend the meetings of the Board of Directors of Warner Brothers?

A. I have. I did so before I joined Warner, also.

Q. You did that from the time in 1927 that you had the connection with Goldman, Sachs that you have referred [784-2] to? A. Yes, sir.

Q. You are not and never have been a director of Warner Bros. Pictures, Inc.?

A. That is correct.

Q. But you have made it a practice since 1927 to attend the meetings of the Board of Directors of that company?

A. Either late '27 or early '28.

Q. I will ask you whether you are the W. S. McDonald who is referred to in the minutes as being present at a number of the meetings?

A. I am.

Q. Mr. McDonald, do you have in mind the meeting of the 25th of September, 1945, at which there was presented to the Board the resignation of Joseph Bernhard? A. I do.

Q. You were present at that meeting?

A. I was.

Q. Can you state whether there was any statement made in connection with the presentation of his resignation as to why he was resigning from

(Deposition of W. Stewart McDonald.)

the positions of Vice-President and director of Warner Brothers?

A. Well, to the best of my recollection, and I am sure this was done, the Board was informed that Mr. Bernhard [784-3] was resigning in order to become affiliated with the new corporation, United States Pictures Company, or whatever the correct title of that company is.

Q. Was anything said as to what, if anything, United States Pictures was to do?

A. Yes. That corporation was being organized for the purpose of producing pictures which were to be distributed by the subsidiary of Warner Bros. Pictures, Inc.

Q. Was anything said at that time with reference to who else would be associated with United States Pictures?

A. Yes, Milton Sperling.

Q. Did you know at that time who Milton Sperling was?

A. I did.

Q. Who was he?

A. Milton Sperling had been formerly affiliated with Fox Film and with other corporations. He was active in the production, writing and producing of motion pictures. He was the son-in-law of Harry M. Warner, President of Warner Bros. Pictures.

Q. Were all of these facts discussed at the directors' meeting at that time?

A. Yes.

Q. You remember, do you, that that resignation of Mr. Bernhard was accepted at the meeting?

(Deposition of W. Stewart McDonald.)

A. That is right. [784-4]

Q. Was there any direction given by Albert Warner or anybody else, to any of the directors, as to how he should vote on that matter?

A. Well, that meeting, I believe, was merely to accept the resignation.

Q. Well, was there any direction given by Albert Warner or any other person as to how any individual director should or should not vote on that proposition? A. No direction.

Q. I now call your attention to a meeting of directors that was held on the 28th of September, 1945, at which it appears that you were also present, and I identify that meeting as being a meeting at which there was presented for action by the Board a contract between United States Pictures Corporation and Warner Bros. Pictures, Inc., in reference to the production and distribution of motion pictures. Do you remember that?

A. I do.

Q. Can you state who presented that contract to the Board?

A. I believe that Major Warner, as presiding officer, first referred to it and then it was discussed or presented more fully by Stanleigh Friedman.

Q. Do you remember whether at that time Stanleigh Friedman made statements which purported to be a recital [784-5] of the terms and conditions of the contract?

A. Yes, and I believe he had with him either a draft of the contract—I do not know if it was

(Deposition of W. Stewart McDonald.)

then in final form, but he at least had full details pertaining to such contract.

Q. Was there any discussion among those present as to the contract, its terms and advisability of having Warner Brothers enter into the contract?

A. Oh, yes. There was full discussion as to the terms and conditions of the contract.

Q. At that time was any director instructed as to how he should or should not vote on the matter?

A. No, sir.

Q. Did the directors vote unanimously to accept that contract?

A. It is my recollection they did.

Q. Do you remember now what the terms of that contract were?

A. Yes. Let me state this, that I have never read the contract or had occasion to read it. The contract related to six pictures to be produced by United States—what is it, Film Corporation?

Q. United States Pictures, Inc.

A. United States Pictures, Inc., to be distributed by the subsidiary of Warner Bros. Pictures, Inc., Warner [784-6] Bros. Distributing Corporation. Warner was to furnish 50 per cent of the financing. The subsidiary was to receive certain percentages for the distribution of the picture, certain charges were to be made in connection with such distribution, such as print costs, advertising, et cetera, and Warner was to share in 50 per cent of the profits of such pictures.

(Deposition of W. Stewart McDonald.)

Q. Those are the terms as you understood them, as stated at the meeting? A. That's right.

Q. Prior to the meeting of the 28th, the meetings of the 25th and the 28th of September, 1945, had you had any knowledge of the fact that such a contract as you have just described was in contemplation by Warner Brothers?

A. Yes, I did.

Q. Had you been out on the Coast immediately prior to that time?

A. I had. I left for the Coast the last part of August and returned around the middle of September.

Q. While you were at the Coast, had you had any conversation with any of the executives of Warner Brothers concerning this contract?

A. I did. I talked at that time to both Harry Warner, President, and Mr. Joseph Bernhard, who was still Vice-President of the corporation, during part of that time. [784-7]

Q. What was the substance of the conversation between yourself and Harry Warner at that time?

A. Harry Warner told me that he was negotiating with Milton Sperling to have him join our organization. He referred to the fact, which I had also known indirectly through other sources, that Milton had been a very successful producer and executive assistant at the 20th Century-Fox organization; that Zanuck, who was the head of production of Fox, wanted Milton to go back to Fox, but that Harry Warner was very desirous of having

(Deposition of W. Stewart McDonald.)

him join the Warner organization and that he was negotiating on behalf of the corporation whereby Milton would become affiliated with Warner Bros. Pictures.

He said that the only way in which he could arrange it would be a basis whereunder Milton would have a financial interest in the pictures produced, which would be done through the formation of a company to be owned partly by Milton. He said that there were several reasons why he was desirous of having him come in. First, his proven ability as a producer of pictures, and secondly the fact that he said he wanted to build up the manpower of the Warner organization.

He pointed out the fact that in case something might happen to Jack Warner that it was essential to have someone to back him up, in a secondary position, and he [784-8] was very desirous to strengthen our position in the producing organization by having Milton come in with the hope that he would develop so that he could take over Jack's position should something unfortunate happen to Jack.

He also told me this, which came up in the conversation with Joe Bernhard as well, that he was very desirous of having Mr. Bernhard become affiliated with United States Pictures, the reason being that Joe had proven business experience, he was a good executive, and that he thought it was very much to the benefit of the company if we could make a deal with the proposed new United States

(Deposition of W. Stewart McDonald.)

Pictures Corporation, which would have as its controlling stockholders, or most likely the sole stockholders, Milton Sperling, an experienced producer, and Joe Bernhard, an experienced business executive.

Q. This occurred while you were on the Coast and prior to the meetings of the 25th and 28th of September? A. Yes, sir.

Q. I call your attention to the fact that on the 23rd of November, 1925, there was a directors' meeting at which there was presented a short amendment to the contract with United States Pictures relating to the withholding of moneys from the United States Pictures for the purpose of reimbursing or paying loans which might be made by that company in connection with pictures. [784-9]

A. That's right.

Q. You remember the details of that matter?

A. Well——

Q. I mean, you remember that it was brought before the Board?

A. I remember that they wanted some amendment to the contract which would aid them in securing the loan from the New York Trust Company.

Q. And that had to do with the Warner Brothers paying the moneys directly to the New York Trust Company instead of——

A. To United States Pictures.

Q. That matter was explained at the Board meeting? A. It was.

(Deposition of W. Stewart McDonald.)

A. It was.

Q. And thereafter the Board approved?

A. Right.

Q. On the 18th of June, 1946, there was a meeting at which it appears that you were present and which involved the matter of an organization known as Hemisphere Pictures, United States Pictures and Hemisphere Pictures involved Niven Busch, the author of a motion picture called Pursued, and Theresa Wright, a screen star. Do you remember that matter having been brought before the Board? A. I do.

Q. Do you recall in general the action that was [784-10] sought from the Board with reference to that picture, Pursued?

A. Yes. I know there was a great deal of discussion to determine if it was to the financial advantage of the company to enter into this modification, for, if I recall correctly, United States Pictures, in making this deal, had to give a percentage of the profit of the picture to Teresa Wright and to the other members of her company, and in giving that percentage therefor in the stars contract and for the rights to the picture, it necessarily meant that the percentage of profits for Warner would be reduced.

It was pointed out, and figures were presented, to show that it was likely to the financial advantage of the company to enter into this modification, in view of the increased percentage terms which the company would receive as a distribution fee.

(Deposition of W. Stewart McDonald.)

Q. That matter was fully discussed by those present at the Board meeting, was it?

A. It was.

Q. And was it passed by the Board?

A. It was.

Q. Now, I call your attention to a contract which was dated December 6, 1947, and which, according to our records, was not at that time presented to the Board but which had to do with the making of four additional pictures, [784-11] which were called additional pictures in the contract, and which changed the terms of the contract with reference to those additional pictures so that Warner Brothers would pay the entire cost of production, the distribution charges would be raised from 20 to 25 per cent for domestic and also raised in England and throughout the other foreign distribution, and Warner Brothers should receive 80 per cent of the profit instead of 20 per cent. Do you remember the existence of that contract, to your knowledge on or about or shortly after December 6, 1947?

A. I remember that it was discussed with me before, while it was in negotiation. I cannot tell you what date it was. If the contract is dated December, 1947, I am sure that it was prior to that time.

Q. To your knowledge, with whom was it discussed and by whom was it discussed?

A. Well, I know that Mr. Schneider and Mr. Bareford worked on the contract. I think Mr.

(Deposition of W. Stewart McDonald.)

Friedman also worked on the contract. I may have discussed it also with Mr. Carlisle.

Q. You discussed it with those gentlemen, did you?

A. Yes. I had nothing to do with the negotiation of the contract, I mean the discussions were of a general nature. But I knew of it.

Q. Do you remember that later in July of 1950 there was a second amendatory contract providing for three [784-12] additional pictures to be made, that is, three in addition to the four provided for by the December 6, 1947, contract?

A. Yes, I recall that.

Q. Was that matter discussed in your presence and by you and by others with you prior to the time that it was presented to the Board of Directors? A. It was.

Q. Were you present at the meeting held on the 17th of August, 1950, at which time the amendment of December 6, 1947, and the proposed new contract of July 21, 1950, was presented to the Board and discussed and passed on by the Board?

A. I was at the meeting; I recall that.

Q. Do you remember whether at that time the matter was discussed by the Board and in the presence of the Board? A. It was.

Q. That action was approved by the Board, was it? A. It was.

Q. Was there any disagreement among the Board as to the advisability of approving that contract? A. There was not.

(Deposition of W. Stewart McDonald.)

Q. May I ask you, was there at any of these meetings any directions or instructions from Albert Warner or any other person to any member of the Board of Directors as to [784-13] how they should vote on any of the matters submitted to them?

A. No, sir. [784-14]

* * * * *

DEPOSITION OF ALBERT WARNER

Plaintiff's Exhibit No. 115: Deposition of Albert Warner, a witness called by and in behalf of the defendants, taken pursuant to Stipulation dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 18th day of May, 1951, at 10:30 a.m., before Arnold Schubert, a Notary Public of the State of New York. [784-25]

* * * * *

ALBERT WARNER

called as a witness by and in behalf of the defendants, being first duly sworn by Arnold Schubert, a Notary Public, of the State of New York, testified as follows:

Direct Examination

Q. (By Mr. Williams): Your name is——

A. Albert Warner.

Q. Where do you live, Mr. Warner?

A. New York City.

Q. Are you connected with Warner Bros. Pictures, Inc.? [784-26]

A. I am, yes.

(Deposition of Albert Warner.)

Q. In what capacity?

A. Vice-President and Treasurer, director.

Q. How long have you been connected with that organization?

A. Since the inception of the corporation.

Q. Prior to that time you and your brothers, Harry and Jack, were in the motion picture business in partnership, were you not?

A. Yes.

Q. You have been in the motion picture business for how many years?

A. More than 45 years.

Q. You make your headquarters at the New York offices of Warner Brothers?

A. Correct.

Q. What are your specific duties in the company?

A. No specific duties; general overall executive, confining most of my activities to the New York end of it.

Q. Your brothers regularly make their headquarters at the studio in Burbank, California?

A. They do.

Q. And in the division of work, they look after the executive problems that arise on the Pacific Coast, and you take care of them here in New York? [784-27]

A. That is correct.

Q. You customarily attend the meetings of the Board of Directors of the company, do you not?

A. I do.

(Deposition of Albert Warner.)

Q. In cases when your brother Harry is not present, you customarily preside?

A. I do.

Q. Do you have in mind a meeting of the Board of Directors of the company which was held on the 25th of September, 1945, and which I will identify as being the meeting at which there was presented the resignation as an officer and director of Joe Bernhard?

A. Yes, I recall that meeting.

Q. Do you remember whether, at the time of the presentation of his resignation, there was any statement made by you or any other person present as to the reason why he was resigning from Warner Bros.?

A. Yes, to the best of my memory he was to join Milton Sperling in the United States Pictures.

Q. Were there any statements made as to what the United States Pictures would do, what business they would engage in?

A. The production of pictures.

Q. Was anything said with reference to whether Warner Bros. would have any connection with United States [784-28] Pictures or any contractual relations with them?

A. Yes, as distributors.

Q. Was that matter discussed among the directors at the meeting at which Bernhard's resignation was presented?

(Deposition of Albert Warner.)

A. Not in general. Some of the directors knew of it. I don't recall whether it was particularly taken up.

Q. Was Mr. Bernhard's resignation accepted at that meeting? A. It was.

Q. Now, three days later, on the 28th of September, 1945, there was a meeting held at which, among other things, there was presented to the directors a proposed contract between Warner Bros. and United States Pictures, Inc., providing for the production and distribution of motion pictures to be made by United States Pictures.

A. There was.

Q. You remember that? A. Yes.

Q. Did you present that contract to the Board?

A. I did.

Q. At the time you presented it to the Board, what if any statements did you make about the contract?

A. I told the directors that it was most advantageous for our company to secure the services of Milton Sperling, who was the producer in charge of the United States [784-29] Pictures. We planned on having a good piece of manpower at the studio so that in case anything happened to Jack Warner, my brother, that we would have somebody ready there to take over and carry on. That thought was in addition to the advantageous advantages of very good pictures that would lend a great deal

(Deposition of Albert Warner.)

of earnings to our theatres and to our overall distribution end of it.

Q. Was there anything said by you or anybody else on the subject of Milton Sperling being the son-in-law of Harry Warner?

A. They all knew that, I imagine.

Q. Was there any discussion at that time about the experience that Milton Sperling had had in producing motion pictures?

A. I explained to them the background he had had as a producer and the successful pictures that he had made.

Q. Do you remember now what pictures he had made?

A. Oh, it is very difficult to remember. One I remember is something about Tripoli, Sands of Tripoli——

Q. Shores of Tripoli?

A. Shores of Tripoli, or something like that, and his general professional experience with the Fox organization.

Q. Where the terms of the contract itself explained to the Board by any person there?

A. Mr. Friedman had a copy of the contract there. He [784-30] also had a resumé, a condensed resumé of the contents of the contract. That was thoroughly explained to the directors. There were copies there available for the directors to take and read. Whether they did or not, I don't recall.

Q. Well, after the statements that you had made and Mr. Friedman's discussion of the terms of

(Deposition of Albert Warner.)

the contract, was the contract approved by the directors? A. It was.

Q. Was there any dissent from that approval?

A. No.

Q. Did you, in connection with that contract or in connection with the prior resignation of Mr. Bernhard, direct or instruct any of the directors to vote in any particular way on either of those subjects? A. We never do that.

Q. You did not in this case? A. No, sir.

Q. Did you make any statement with reference to whether you and your brothers were favorable to the contract?

A. We were favorable to the contract.

Q. Did you make a statement to that effect to the directors? A. I must have. [784-31]

Q. I now direct your attention to the fact that a meeting of the directors was held on the 23rd of November, 1945—of course, you won't remember the date, but I am just calling your attention to the fact that there was a meeting held on that date, and on that date there was a short amendment of one paragraph of the agreement between United States Pictures and Warner Brothers presented to the Board for approval, and that particular amendment had to do with the fact that, there being bank loans by United States Pictures, it provided that Warner Brothers, out of the moneys coming in from the distribution of the pictures, should withhold certain sums that would otherwise be due to the United States Pictures and pay the bank

(Deposition of Albert Warner.)

loans with them. Do you remember the circumstances of that meeting?

A. Are you referring to the Teresa Wright-Busch——

Q. No, I am referring to just a little amendment clarifying the fact that Warner Brothers, from the money received from the distribution of the pictures, should first pay the bank loans that United States Pictures had made.

A. I don't recall the specific wording of that, but the minutes show that such a meeting took place.

Q. You were present at that meeting and voted in favor of it, although you do not now remember the details?

A. To the best of my knowledge, I was present.

Q. Now, on the 18th of June, 1946, there was presented [784-32] to the Board of Directors at a meeting a proposed amendment to the contract with reference to the picture Pursued, which was a picture written by Niven Busch and in which Teresa Wright was to appear, and they had a corporation known as Hemisphere Pictures.

A. Yes, I recall that.

Q. You remember that? A. I do.

Q. What, in effect, in substance, was that deal?

A. We were anxious that the United Pictures secure Teresa Wright in the Niven Busch *Prusit* Story. We saw the possibilities of a box office attraction of that kind, and our judgment was correct; it proved very successful.

(Deposition of Albert Warner.)

In order to make that possible, on account of the setup of the Fidelity Company and the setup of the United States Pictures, we had to make some modifications to permit such a deal to be acquired, and the net results of the change in the figures and percentages, whatever they were, came out just the same as if no changes were made. It was a move made necessary to secure the services of Teresa Wright and Busch in the picture *Pursued*.

Q. You personally were favorable to that amendment? A. Very much so.

Q. Did you state the problem to the Board before they passed on it? [784-33] A. Surely.

Q. Do you remember that that involved that Warner Bros. should receive one-third of the total profit instead of one-half, but that on the other hand the distribution percentage was increased with reference to that picture from 20 per cent to 25 per cent, and also the overhead to be charged by Warner Bros. for the use of its facilities was increased?

A. What ever the specific figures were, in the end they all came out the same as if those changes were not made. The distribution advance from 20 to 25 per cent was one item.

Q. Now, in connection with the voting on that amendment, did you dictate or direct any director how he should vote on the matter?

A. We never do those things.

Q. Well, without my asking you again, it is a

(Deposition of Albert Warner.)

fact, is it not, that in reference to every time when this United States Pictures contract was presented to the Board in any form, that there was never any direction by you given to any member of the Board as to how he should vote on the matter?

A. No. As I said, we recommend such propositions.

Q. But not directed?

A. Never directed. [784-34]

Q. I now call your attention to the fact that on the 6th day of December, 1947, there was an agreement made between Warner Bros. Pictures and United States Pictures, Inc., which provided for an amendment to the basic agreement under the terms of which United States Pictures were to make four additional pictures, and the conditions of making of those pictures were changed in several particulars: First, instead of putting up 50 per cent of the cost of production, Warners were to put up 100 per cent of the cost of production; second, instead of a distribution fee of 20 per cent domestic and 25 per cent British, and varying percentages for other foreign distribution, the distribution fee was to be 25 per cent domestic, 30 per cent British, and 30 per cent for the other foreign distribution; in the third place, the profits from the production of the pictures were to be divided, 80 per cent to Warner Bros. and 20 per cent to United States Pictures, instead of 50 per cent to each, as under the original agreement.

(Deposition of Albert Warner.)

Do you remember the circumstances of such a contract having been made?

A. Yes, I do.

Q. And do you remember that that contract was made in December of 1947, and are you aware of the fact that thereafter certain pictures were made pursuant to that amended contract? [784-35]

A. Yes, I do.

Q. Now, it just happens, Mr. Warner, that that contract was not presented to the Board of Directors for consideration at that time, but on the 21st of July, 1950, some little time later, there was a second amendment providing for three additional pictures, three more additional pictures on substantially the same terms as the pictures provided for under the agreement of December 6th and extending the time within which all of the pictures under all of the contracts should be made. Do you remember the circumstances of that agreement being made? A. I do in a way, yes.

Q. That agreement was presented to the Board of Directors at a meeting held on the 17th of August, 1950, and there was a great deal of business done at that meeting, but in particular I direct your attention to the last page, where the words beginning "The Chairman" in the paragraph that starts near the top, on down to the end of that page, recites the facts with reference to this matter. I ask you to read it.

A. (Reading): "The Chairman stated——"

Q. Well, read it to yourself.

(Deposition of Albert Warner.)

A. Oh, pardon me. (Perusing minutes.)

Q. Have you completed reading that, Major?

A. I want to read it over again. (Perusing document [784-36] again.)

Q. Major, you have read the portion of the minutes of the directors' meeting of August 17, 1950, referring to the second amendatory agreement between United States Pictures and Warner Bros. Does that refresh your recollection as to that matter having been brought before the Board of Directors? A. It was, yes.

Q. And did you present it to the Board?

A. I did.

Q. Did the Board pass favorably upon it?

A. They did.

Q. In your judgment at that time, was that good business for Warner Bros.?

A. It sure was.

Q. In your opinion, was this entire United States Pictures contract, including all of the amendments that were made, for the benefit of Warner Brothers? A. Substantially profitable.

* * * * * [784-37]

DEPOSITION OF WADDILL CATCHINGS

Plaintiff's Exhibit No. 116: Deposition of Waddill Catchings, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th Street, New York, N.Y. on the 17th day of May, 1951, before Arnold Schubert, a Notary Public of the State of New York. * * * * * [784-65]

Direct Examination

Q. (By Mr. Williams): Mr. Catchings, you are a director of Warner Bros. Pictures, Inc.?

A. Yes.

Q. And have been for how long a period of time? A. Nearly 30 years. [784-66]

Q. I want to review very briefly your business experience. What is your profession?

A. Well, I am a member of the Bar, but I haven't practiced since 1909.

Q. Have you graduated from——

A. Harvard Law School.

Q. Harvard Law School? A. Yes.

Q. After leaving Harvard, did you engage in practice here in New York?

A. Yes. I was with Sullivan & Cromwell from 1904 until 1909.

Q. In 1909, into what business did you go?

A. Well, it really was—I was really out of the law before I left Sullivan & Cromwell. My purpose in going into Sullivan & Cromwell was to engage in business law, business activities, and in 1907 I

(Deposition of Waddill Catchings.)

was sent by the firm to assist the receivers of Milliken Brothers and made my office with them, and that was from 1907 on; and in 1909 I left Sullivan & Cromwell and became an employee of the receivers of Milliken Brothers, and after that receivership ended I was appointed receiver of the Central Foundry Company—that was about 1910, I should think—and when that company was reorganized I became president of it, and continued as president of it [784-67] for a period of about ten years.

I also was president, beginning at about 1912, of the Platt Iron Works Company, in Dayton, Ohio, and continued as president of that until the company was liquidated about ten years later.

In 1915 I became associated with E. R. Stettinius in the Export Department of J. P. Morgan & Company, which was the division of J. P. Morgan & Company that did the buying for France and England before the United States entered World War I. I continued there until April, 1917, just before we entered the war, and in 1917 I became president of the Sloss-Sheffield Steel & Iron Company, of Birmingham, Alabama, and then in 1918, the first of January, 1918, I became a partner in Goldman, Sachs & Company, the banking firm, and I continued as a partner in Goldman, Sachs & Company until 1930.

Q. In addition to the corporations you have mentioned, you have also been a director and officer or otherwise connected with a great many other corporations, have you not?

(Deposition of Waddill Catchings.)

A. Yes, sir. It was the practice of Goldman, Sachs & Company, to have a partner on the Boards of Directors of companies for which they issued securities, and I was the senior partner in Goldman, Sachs & Company most of the time and I was on a great many Boards of Directors, such [784-68] as Sears, Roebuck, Underwood Typewriter Company, Cluett, Peabody Company, and at least 15 or 20 others.

Q. Among others, you have been and are now a director of Chrysler Corporation, are you not?

A. I have been a director of the Chrysler Corporation since 1929.

Q. How did you come to become a director of Warner Brothers?

A. Well, Goldman, Sachs & Company issued stock for Warner Brothers, and I went on the Board, as was the practice, to represent the public stockholders on the Board of Warner Brothers at the time the stock was issued.

Q. You went on the Board about 30 years ago?

A. Yes. I think it was about 1924, not quite 30 years ago.

Q. And you have been on the Board ever since?

A. I have, yes.

Q. You have no employment by Warner Brothers or any connection with Warner Brothers other than as a member of the Board of Directors, have you?

A. No, that is correct. I haven't had for a great many years.

(Deposition of Waddill Catchings.)

Q. In addition to that, you also have other interests outside of Warner Brothers which take up your time?

A. Oh, well, I am actively in business in the [784-69] production of radio programs at the present time.

Q. The only connection you have is, in getting money from Warner Brothers, that you get a director's fee occasionally?

A. I do, yes, it has been rather occasionally in the past; recently it has been more frequent, but for many years it hasn't been much. Directors do not receive salaries from Warner Brothers. They get a fee of \$50 for attending a Board meeting.

Q. Now, Mr. Catchings, I direct your attention—incidentally, so that there may be no misunderstanding about this, I had a talk with Mr. Catchings a day or so ago and went over these various meetings with him so as to refresh his recollection as to the meetings.

I call your attention now to a meeting of the Board of Directors of Warner Bros. Pictures, Inc., which was held on the 25th of September, 1945, and in order to refresh your recollection as to the particular meeting concerning which I am going to question you, I want to say that at that meeting the resignation of Joe Bernhard as Vice-President and Director of Warner Brothers was tendered to the directors. That sufficiently identifies the meeting for you, does it? A. Yes.

Q. Do you remember at that time whether in

(Deposition of Waddill Catchings.)

connection [784-70] with the presentation of Mr. Bernhard's resignation, any statement was made concerning the reasons for his resignation?

A. Yes. He was resigning to go into the production of motion pictures. A corporation was being formed jointly by him and Milton Sperling. I think it was called the United States Pictures Corporation.

Q. At that time the directors did, as the record shows, accept his resignation? A. Yes.

Q. Was there anything said at that time as to who Milton Sperling was? A. Yes.

Q. What was stated in that regard?

A. He was stated to be a son-in-law of Harry Warner's, but that was well known anyhow, and it was stated that he was going into the business with Joe Bernhard and that the two were to engage in business together and they were going to make some contract with Warner Brothers under which they would have the use of Warner Brothers' facilities on the same terms, or generally speaking the same terms, as prevailed with respect to other independent producers that worked on the Warner lot.

Q. In connection with your vote on this measure, I take it from the minutes that you voted to accept the [784-71] resignation? A. Yes.

Q. Did anybody at that time, or in connection with it, state to you how you should vote?

A. No.

(Deposition of Waddill Catchings.)

Q. When you did vote, did you do so in the exercise of your own independent judgment?

A. I did.

Q. I call your attention to a next meeting of the Board of Directors, which was held just three days later on the 28th of September, 1945, at which the record shows that you were present and at which time, in order that you may identify the meeting, a proposed contract between Warner Bros. Pictures, Inc., and United States Pictures, Inc. was presented to the Board for consideration. I ask you whether you have any recollection of what transpired at that meeting.

A. Well, there was a brief outline of the terms of the contract and there was quite a little discussion with respect to the contract, what it covered and the commitments that the company was making, the commitments that were being made to the company.

Q. Do you remember any of the details of that contract?

A. No. It wouldn't be possible for me to remember [784-72] back that far the details of a contract.

Q. Do you have any recollection as to whether Warner Brothers were to put up any of the financing for that deal?

A. No, I do not.

Q. Do you remember what the division of profit was to be in connection with the matter?

A. No.

Q. Now, at the time was the matter——

A. I knew it at the time.

(Deposition of Waddill Catchings.)

Q. Yes, I appreciate that. At the time was there a considerable discussion about the terms of the contract? A. Yes, there was.

Q. Do you remember whether Mr. Friedman was present at that time?

A. Yes, he was, and I think he presented quite a summary of the terms of the contract.

Q. At the time you voted on that contract—I take it you did vote in favor of authorizing the entering into the contract? A. I did.

Q. Did any person say to you in what way you should vote on that matter? A. No.

Q. When you voted, did you exercise your own independent judgment as to the manner in which you should vote? [784-73] A. I did.

Q. Did you consider that contract to be a good contract from the business viewpoint for Warner Brothers? A. I did.

Q. Incidentally, was there anything said either at that meeting or at the preceding meeting on the subject of Milton Sperling, as to whether he had had any experience in the production of motion pictures?

A. Yes, I think he was—I think that so far as I am concerned, I think I knew it before that, but I think it was covered in the meeting that he had met with considerable success in work for other moving picture companies and was a very promising young person in the moving picture business.

Q. And you had that information when you voted on this contract? A. Yes.

(Deposition of Waddill Catchings.)

Q. I now call your attention to a meeting which was held—incidentally, I almost overlooked something. You were out on the Pacific Coast and in and about Los Angeles immediately prior to this meeting of the 25th of September, were you not, or shortly prior to that?

A. Well, I had been out there on so many occasions that I don't know—I would have to look up some records to tell whether I was out there just prior to this. But I have been going to Hollywood in connection with Warner activities repeatedly over a long period of time.

Q. Let me ask you this: Do you remember having had one or more conversations at or about this time with Mr. Harry M. Warner in Hollywood and perhaps here in New York in which there was some discussion about this proposed contract or this contract with United States Pictures and Sperling and Bernhard?

A. I think that the discussions at that time with Harry Warner occurred in New York with respect to Sperling and Bernhard. He was here some time before that meeting, and whether he talked to me at that time or not, I don't know. But he was here shortly after the meeting and he went over the thing at considerable length, covering much the same ground that had been covered in the statements that were presented to the Board.

Q. Do you have any recollection of anything that he stated as to the reasons why he believed that the making of such a contract by Warner Bros.

(Deposition of Waddill Catchings.)

Pictures, Inc., with United States Pictures, Inc., would be a good thing for Warner Brothers?

A. Yes. He had great confidence in the ability of Joe Bernhard, as we all did. I had known Joe extremely well for a period of years and had a very high regard for him, and high expectations were held as to the success that would [784-75] come from the exercise of his abilities in the production of pictures; and also the fact that working under a man such as Joe, a man with such ability as Joe, that Milton Sperling would develop very rapidly in accordance with the promise that he gave from the work that he had already done.

It was thought that training under Joe would be very, very beneficial to Milton and his growth and development.

Q. Was there anything said as to what interest Warner Brothers might have in the growth and development of Milton Sperling?

A. It is very hard, Mr. Williams, for me to say how much I knew at that time and how much I knew later than that time, because you can't divide your memory up into sections like that. As far as I know, from the time that these arrangements were made with Milton, I had high hopes that Milton would grow to be a very important person on the Warner lot who would have real possibilities of high executive position in the course of time.

Q. Was anything said to you by H. M. Warner or any of the other officers of Warner Brothers at that time about the desirability of having somebody

(Deposition of Waddill Catchings.)

on the Warner lot with such experience that he would be able to take over in case anything happened to Jack Warner?

A. Oh, yes, that was certainly the subject of discussion. [784-76] I think I ought to say here that it has always been a deep conviction of mine that a man could not develop for headship in a company under someone else, that—I mean, to succeed them, that he had to have responsibility of his own, and I thought that the conditions that we created with respect to Milton would give him a chance to *drown* if he had in him the qualities that he appeared to have, and grow in a way that would be much better than if he were acting as an assistant or a subordinate of Jack Warner.

* * * * * [784-77]

Q. (By Mr. Williams): The next meeting was the 23rd of November, 1945, and on that date a meeting was held in reference to an amendment, or amendatory letter, having to do with the clarification of the fact that in case United States Pictures borrowed money from any bank or banks, that that money was to be paid back to the banks by Warners before they got any money out of it themselves?

A. Yes.

Q. You remember the circumstances of that meeting?

A. Well, I have seen those minutes recently and that refreshes my recollection. I don't remember it apart from that.

Q. At any rate, you do remember that the mat-

(Deposition of Waddill Catchings.)

ter had to do with a small amendment in connection with the bank loan?

A. Yes, I remember that very well.

Q. And at the time you voted in favor of the subject? A. Yes.

Q. At that time, or in connection therewith, did any person say to you in what manner you should vote on that? A. No.

Q. And when you did vote, you used your own independent judgment in the matter?

A. Yes. [784-78]

Q. I call your attention next to a meeting that was held on the 18th of June, 1946, at which it appears that you were present and at which there was presented to the directors a matter of a change of the terms of the basic United States Pictures Company agreement with reference to a picture called Pursued, and the organization of a corporation called Hemisphere Films, which was the corporation in which Niven Busch, the author of the picture Pursued and Teresa Wright, the star that was proposed to be used in the picture, should be stockholders. Do you remember the circumstances of that matter being brought before the Board?

A. Well, I have examined those minutes and, with the aid of the minutes, I recall that it took place; but I couldn't have done it without seeing the minutes.

Q. Well, do you remember now, having refreshed your recollection, that at that meeting the matter was discussed and that it involved Warner Brothers

(Deposition of Waddill Catchings.)

taking a smaller proportion of the profits, but on the other hand getting a larger proportion of the distribution costs and overhead? A. Yes.

Q. Do you remember whether at that time there was presented to the Board an analysis of some figures based on assumed grosses that Mr. Carlisle had presented, discussing what the probable profits to the corporation *would* [784-79]

A. Well, that was common practice, but remembering whether the thing was done specifically, I mean, I can't imagine it was omitted, but I can't go back after all this time and say that I would specifically recall that particular thing having been presented.

Q. Well, the record shows that this was adopted unanimously, and I take it that you voted for the change? A. I did.

Q. In doing so, you used your own judgment and were not dictated to by anybody else?

A. That is correct.

Q. I now call your attention to a fact which has come to light in connection with a contract which has been referred to here as the letter agreement of December 6, 1947, and which was identified on May 3, 1949, in connection with the discovery proceedings as Plaintiff's Exhibit 6. This an agreement which provides for the production of four additional pictures. The original contract, as you will remember, provided for the production of six pictures, and it involved a distribution of the profits, 50 per cent to Warner Brothers and 50 per

(Deposition of Waddill Catchings.)

cent to United States Pictures; it also provided that Warner Brothers would share half of the cost of producing the pictures and that the domestic distribution fee should be 20 per cent.

Now, this letter of December 6, 1947, was not at [784-80] that time presented to the Board of Directors but was executed on behalf of Warner Bros. Pictures, Inc., by R. J. Obringer, Assistant Secretary. It provides in substance that Warner Brothers shall put up the entire cost of four additional pictures, without reference to the first group of pictures; that the overhead to be charged to United States Pictures will be enlarged and increased; that the domestic distribution charge will be increased from 25 to 25 per cent, with some additional increases for foreign distribution; and that upon the distribution of the picture, the profits, after paying off all costs and distribution charges, will be divided 80 per cent to Warner Brothers and 20 per cent to United States Pictures.

Now, with that in mind, I call your attention to the fact that on the 17th of August, 1950, there was held a special meeting of the Board of Directors of Warner Brothers at which a third amendment providing for three additional pictures on top of these four additional pictures was presented to the Board, the conditions of production of the three additional pictures being substantially the same as those of the four additional pictures. Do you remember that matter being brought before the Board on or about the 17th of August, 1950?

(Deposition of Waddill Catchings.)

A. Well, with the same qualification that I made before, that the fact that it is recorded in the minutes [784-81] I used that to refresh my recollection. I do not have to have my recollection refreshed with respect to the two transactions, because I have a recollection that I was in Hollywood at some time prior to this meeting in 1950, and possibly in 1947, and that I knew at the time what was being done with respect to enlarging or adding to the activities of Milton Sperling there on the Warner lot. I have a very vivid recollection of having been present in Harry Warner's office at a meeting between Harry and Milton Sperling with respect to modifications in the contract, as I was in Hollywood at the time, and Harry told me he was going to have a talk with Sperling and invited me to come and sit in his office while the discussion took place. That I remember very vividly, because I had never had a chance of seeing Milton Sperling in action, so to speak, and the manner in which he conducted the discussion with Harry, his thorough fairness, made a very lasting impression on me. It was the first time I came to know much of the man, of the ability that he undoubtedly has. Before that I had to take it more or less on hearsay.

Q. That was prior to this meeting of August 17, at which the matter came up before the board?

A. You are talking about August 17, 1950?

Q. Yes. [784-82]

A. Oh, yes, it was some time prior to that, and while I am not certain as to just when it occurred

(Deposition of Waddill Catchings.)

in Hollywood, I should say that it occurred somewhere around 1947.

Q. I will show you now these minutes of August 17, 1950, and it is only necessary for you to refer to the last page, Mr. Catchings, because that is the only part that deals with this subject, and ask you to examine those minutes and refresh your recollection from that examination. Then I will ask you some questions.

(The witness examined the minutes referred to.)

Q. You have now examined the minutes. I will ask you whether you now remember that the matter of the approval by the directors of the change that had been made in the contract was brought before the board and passed on. A. Yes.

Q. And you voted in favor of it?

A. Yes.

Q. And at the time you voted in favor of it, did you do so of your own independent volition, without any suggestions or statements from other persons? A. Yes.

Q. And this vote by you was after you had known of the pendency of these changes through having participated, at least as a spectator, in the conferences between [784-83] Milton Sperling and Harry Warner?

A. I participated more than as a spectator. I was there as a director of the company, but I didn't engage in the discussions.

(Deposition of Waddill Catchings.)

Q. And you did personally approve of the changes in the contract?

A. Oh, very definitely.

Q. Let me ask you this, Mr. Catchings: I preface it by saying, of course, this company is Warner Bros. Pictures, Inc., and Harry Warner is president, Major Albert Warner, Vice-President, J. L. Warner is Vice-President, all of them are directors, and Harry Warner is the executive head of the company, and Major Albert Warner is the Treasurer, and Jack Warner is the head of production; naturally, you think of the Warner Company.

Let me ask you this: You have been a member of the Board of Directors of this company for almost thirty years. At any time have any of the Warner brothers undertaken to direct you as to how you should vote in reference to any matter that came before you as a director of this corporation?

A. Certainly not.

Q. In its inception you came on to this board as a representative of the public stockholders?

A. That's correct. [784-84]

Q. And you have had, I think you stated, a very large experience as a director of many publicly held corporations?

A. That is true. * * * * *

Q. Will you state as to whether, in voting upon any of these matters as to which you voted, Milton Sperling's being a son-in-law of Harry Warner was given consideration by you in connection with the contracts?

A. Well, I knew that he was a son-in-law of

(Deposition of Waddill Catchings.)

Harry Warner, so I couldn't fail to give consideration to the fact; but it certainly did not influence my voting in favor of any of the contracts.

I would like to put the answer in the negative, and that is that I can conceive of no reason why I should vote against Milton Sperling because he was a son-in-law of Harry Warner. [784-85]

Q. Well, state just as frankly as you can what your attitude toward the situation was in view of the fact that Milton Sperling was a son-in-law of Harry Warner's.

A. Well, Milton Sperling, as I have said repeatedly in my testimony here, was a very able young man and there was certainly no reason, because he was related to Harry Warner, in my opinion for voting against him. As a matter of fact, the close relationship which existed between him and Harry Warner was much in his favor, as far as I was concerned, because Warner Brothers was conceived and always has been and is today, a family company. It is run by the three Warner brothers, the executive end of the business, and its great strength and its magnificent growth has been a result of the splendid and harmonious relationship which has existed between the brothers as members of the family, and I think Warner Brothers is somewhat unique in that respect, that it is a great public corporation and yet it is a family company.

Q. What did you have in mind in connection with Milton Sperling's relation to Harry Warner being an advantage to the corporation?

(Deposition of Waddill Catchings.)

A. I mean by that that Milton saw a great deal of Harry, and Harry had a great deal of confidence in him, and Harry's team, in running the company, was a team at the top composed of members of the Warner family and if you [784-86] could have a man of great ability added to the team, who was also a member of the Warner family, even as a son-in-law, it seemed to me to be a strong point in his favor.

Mr. Williams: I have no further questions.

Cross Examination

* * * * *[784-87]

Q. (By Mr. Pottish): You do not have any large stockholdings in Warner Bros. Pictures?

A. No, I haven't personally.

Q. Is it a fact that from year to year, when the Board of Directors of Warner Brothers is put forth, the slate is put forth by a Nominating Committee?

A. I don't know that there has been a formal Nominating Committee.

Q. Well, are you familiar with the mechanics whereby each year, at the annual meeting of stockholders, a slate of directors is presented to the public stockholders for voting?

A. I certainly am familiar with that, but that is [784-90] by action of the Board of Directors itself. It selects the nominees to be submitted in behalf of the company to the stockholders.

Q. The existing Board of Directors selects the

(Deposition of Waddill Catchings.)

slate which will be presented at the next meeting of the stockholders?

A. Yes. Well, but it is presented to the Board prior to the meeting.

Q. Yes. Isn't there some Executive Committee which has some control as to who shall be named in that slate?

A. I don't know of any.

Q. Is it a fact that the three Warner brothers, or the Warner brothers' family controls the slate of directors which is annually presented to the stockholders?

A. I wouldn't say that. I should say that it is the action of the Board of Directors. There have been changes made in the Board of Directors from time to time, and they have been discussed among the directors. I have never felt that the Warner brothers were dictating to me as a member of the Board as to what names to submit to the stockholders. Each year there comes a time when we appoint a proxy committee, and when we authorize the calling or the solicitation of proxies and the submission to stockholders of a list of candidates, and that is a matter of discussion in the Board, and the Warner brothers [784-91] express their opinion, and anybody else that has any opinion is entitled to express it, and I can say to you positively that I think if there was any objection to anybody, that they wouldn't be submitted.

The Warner Brothers' Board has not been a Board of divided action; it has been one of the fine

(Deposition of Waddill Catchings.)

qualities of Harry Warner and his leadership of the company to devise his policies in accordance with the advice that is given to him and his knowledge of the attitude of the Board of Directors. I think he has shown as much deference to the outside men that are on the Board of Directors as any corporate head I have ever known.

Q. But am I correct in saying that it is considered that the leadership of the company lies with the Warner brothers and their family?

A. Well, I covered that quite fully a while ago, I say that so far as the corporation leadership is concerned, the corporate leadership is of the officers of the company, which is precisely the same as every other corporation I have ever been on.

Harry Warner speaks not as a member of the Warner family but as the President of the company, when he is addressing a recommendation to the meeting.

Q. Well, you know, do you not, that the Warner brothers control a large block of stock in the company? [784-92]

A. Yes, that is public knowledge, I think.

Q. And would it be an unfair statement to say that if the Warner brothers desired to keep somebody off the slate, that there would be no question about the fact that such person would be kept off the next slate of the Board of Directors?

A. I wouldn't say that was so. I think that it is purely a matter of speculation as to what would happen if there was a difference of opinion between

(Deposition of Waddill Catchings.)

the Warner brothers and those of us who are not connected with the company or members of the family. That situation has never arisen. But I have never seen any indication of a desire by Harry Warner to force upon the Board of Directors any nominees that were not agreeable to the Board.

Q. Would you feel as though you would be willing to act on the Board of Directors against the opposition of the three brothers?

A. You mean would I be willing to oppose them in the Board?

Q. No, no, that is not what I said. I said: Would you feel that you would want to act as a director if you were advised by the three Warner brothers, prior to a coming election that they preferred that you no longer act as a director?

A. Well, I don't know. That is a speculative [784-93] question. There might very well be circumstances where I would want to get off. But on the other hand, the circumstances might be such that I would want to put up quite a fight. I have had this rather long experience in business and on Boards of Directors, as I have testified here, and that situation has never arisen in any company, and just what I would do under those circumstances, I can't tell. I used to think, when I was on the Board of Directors of Goldman, Sachs & Company, that I didn't need anybody else on the Board except me, that I didn't care how many other people there were, if I were right I could persuade the Board of Directors to act the way I thought they should,

(Deposition of Waddill Catchings.)

and I always did, and I didn't want any lieutenants or anybody there. I have always found the executive heads of companies responsive to reasonable argument.

So when you ask me what would happen if I were opposed to something the Warners said, it is just inconceivable to me that that situation would develop.

Q. Well, my point is this: Do you feel that you could be elected to the Board of Warner Brothers over the opposition of the three brothers?

A. I think that might very well be true, if they were to take a high-handed arbitrary attitude; but I don't know whether now, as I say, in the twilight of my life, I would have sufficient influence to do it, but [784-94] certainly there have been plenty of times in the past, and if the Warners had wanted to push me around I could have formed a group that might well have pushed them around. They have never had an open and shut control; they had only started with a certain amount of stock, and there have been plenty of stockholders on the outside. * * * * * [784-95]

Q. How many members of the public—and when I say that, I mean directors similar to yourself, whose origin as directors started from representing public stockholdings—how many such public members of the Board of Directors are there on Warner Brothers' Board?

A. Well, I don't think there is any one on Warner Brothers except myself who started as a rep-

(Deposition of Waddill Catchings.)

representative of the public. Goldman, Sachs & Company were the original bankers. Later on, Hayden Stone had something to do with Warner activities, and Dick Hoyt came on the Board as a representative of the public, but he got off in the course of time, and, so far as I know, I am the only one that ever started as a representative of the public. That does not mean that I am the only independent director on the Board. Jack Bierwirth is a man of very real and far-reaching independence in business. Charlie Guggenheimer is a well-known and successful lawyer, and Morris Wolfe is a most [784-96] character and entirely independent; I don't think anybody can control Morris Wolfe. He is a very distinguished lawyer in Philadelphia, as you know. * * * * *

Q. You testified that it was stated at that meeting that Milton Sperling was his son-in-law and that he was going with Joe Bernhard. Now, who made these presentations [784-97] or these statements?

A. Well, I think I testified a while ago that Mr. Stanleigh Friedman made a long analysis of the contract and presentation, and I think that he conducted the main part of the discussion; but statements were made—I haven't verified it from the minutes, but I imagine that Albert Warner was there and talked on the subject, and certainly later on Harry Warner was at some of the meetings and he talked plenty on the subject.

Q. If I may get back to the meeting preceding

(Deposition of Waddill Catchings.)

the meeting at which the contract was approved, and that is the meeting at which Bernhard's resignation was presented, you told us that it was stated that Milton Sperling, the son-in-law of Harry Warner, was going in with Joe Bernhard and that they were going to make a contract with Warner Brothers—and I am just giving the substance of what I think you said—on the same terms as prevailed with other independent producers that work on the Warner Brothers lot.

A. I think that is right.

Q. Now, did you have, or do you have now, any detailed knowledge of what the terms of the contracts are with other independent producers on the Warners Brothers lot?

A. No, but I have at time read them from beginning to end and have been thoroughly familiar with them. [784-98]

* * * * *

Q. Did Stanleigh Friedman at that time, do you recall, brief the Board on whether or not that contract was similar to other contracts with other independent producers and give the details of those similarities? [784-99]

A. I think he did so by reference. I think he mentioned at the time that it is a contract similar to such-and-such that we made with other people, then mentioning their names.

Q. At the time he said that, did you then have an independent knowledge as to whether or not the terms were identical or similar between this U. S.

(Deposition of Waddill Catchings.)

Pictures contract and other independent producers?

A. No, I said a few minutes ago, I didn't read the contract before action at the Board. I acted on the statement that was made by Stanleigh Friedman.

Q. And you relied on his statement, did you not, that the contract was similar to contracts made with other independent producers on the Warner lot?

A. Yes.

* * * * *

Q. Would you remember whether or not, at that meeting, Major Warner recommended that the contract be approved? [784-100]

A. Oh, undoubtedly. He was present at the meeting, I assume.

Mr. Williams: Yes, he presided.

The Witness: He undoubtedly recommended it.

Q. Did that carry weight with you in your own mental deliberations as to whether the contract should be approved?

A. Well, he was transmitting a recommendation from the Coast, as we call it, with respect to this contract, and I don't think that anything that Major Warner said added anything. He was presenting the recommendations of his two brothers, H. M. and J. L., and they were the ones who were primarily concerned with the contract.

Q. Did that recommendation mean something to you? A. It did.

Q. Would you say that you placed a lot of faith in the recommendations from the Coast?

(Deposition of Waddill Catchings.)

A. Oh, yes. I don't know how to run the company from New York without placing faith in the recommendations from the Coast.

Q. Was that pretty much, do you think, the belief and actions of the other members of the Board, too?

A. Well, I can't testify about the other members of the Board. [784-101]

* * * * *

Q. You testified too, Mr. Catchings, that you had some conversations, or at least one conversation, with H. M. Warner in New York concerning Sperling and Bernhard, but as I recall, you testified you did not recall whether that conversation was before or after the meeting of September 28, 1945.

A. I think that I said that it occurred after that time.

Q. After the meeting? A. Yes.

Q. And at that time you got the impression from H. M. Warner that he thought it was a good contract? A. Yes.

Q. And he spoke highly of Mr. Bernhard and the help he would be in making a success of that venture for you at pictures?

A. Yes. He was particularly emphatic upon the benefit to Milton as a young man in growing up under the very real wisdom of Joe Bernhard. Joe Bernhard had not spent his life in the moving picture business, as you know; he had come into Warner Brothers from real estate activities, as far as

(Deposition of Waddill Catchings.)

I recollect, and had been extraordinarily successful in his executive work here in the handling of the theatres and was a man of ripe experience and wisdom, and the emphasis was on the benefit to Milton, who was growing up in the motion picture business, of association with Joe, not because of what Joe knew about the making of pictures, but what Joe knew about the world, and life, and his general executive ability. [784-103]

* * * * *

Q. Well, at any time prior to the approval at any of these meetings of these subsequent amendments to the basic agreement, had you made any independent investigation [784-105] as to how the contract was working out?

A. Well, I don't make any independent investigation. I had information from Carlisle from time to time as to how the pictures were turning out. I have been pretty well informed as to what pictures were successful and how much money we were making on them, and things of that sort.

Q. Did you at any time prior to these amendments investigate or exercise any surveillance over the administration of the contract with regard to the amount of overhead that was being charged by United States Pictures?

A. Oh, no.

Q. As its share?

A. Oh, no. That is entirely outside of my function as a director. * * * * * [784-106]

DEPOSITION OF C. S. GUGGENHEIMER

Plaintiff's Exhibit 117. Deposition of Charles S. Guggenheimer, a witness called by and in behalf of the defendants, taken pursuant to Stipulation dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 17th day of May, 1951, before Arnold Schubert, a Notary Public of the State of New York. [784-109]

* * * * *

Direct Examination

Q. (By Mr. Williams): Mr. Guggenheimer, what is your occupation or profession?

A. Lawyer.

Q. How long have you been practicing law?

A. I was admitted in 1899.

Q. And you have been practicing all that time in New York City, have you, Mr. Guggenheimer?

A. Yes, sir.

Q. You are a member of what firm?

A. Guggenheimer & Untermeyer, in New York, and Guggenheimer, Untermeyer, Goodrich & Amram, in Washington, D. C.

Q. Your work has involved your being attorney for and director of and officer of many corporations, I take it?

A. That is correct. [784-110]

Q. And has covered that entire period from 1899 up to the present time, with, I can assume, a little less activity in the earlier years?

A. A little less activity so far as being a director, and so forth, is concerned; very much less.

(Deposition of Charles S. Guggenheimer.)

Q. But during the major portion of your career as a lawyer, you have had close connections as director and officer and attorney for many corporations? A. Yes, sir.

Q. And you are now a director of Warner Bros. Pictures? A. I am.

Q. And have been for how many years?

A. The early '30's; I don't remember exactly whether it is '31, '32; it was the early '30's.

Q. Your firm has now and from time to time has had some connection with Warner Bros. as attorneys for them in certain matters?

A. We have.

Q. You have been from time to time and now are under retainer from Warner Bros.?

A. We are on a retainer from them today.

Q. Warner Bros. are not your principal client by any means, I take it?

A. No. [784-111]

Q. And your professional connection with Warner Bros. is not by any means your means of making a livelihood? A. It is not.

Q. Do you have any office or employment with Warner Bros. other than director, except for the retainer it pays your firm? A. None.

Q. You never have had? A. Never.

Q. Have you made it a practice of attending practically all of the meetings of the Board of Directors of Warner Bros. Pictures, Inc.?

A. I would say yes.

Q. Now, I call your attention specifically—

(Deposition of Charles S. Guggenheimer.)

Mr. Williams: And I may say for your benefit, Mr. Pottish, that within the last few days I have gone over these minutes with Mr. Guggenheimer with the idea of bringing his mind to the subject under discussion and refreshing his recollection so far as it may be refreshed from examining the minutes, and I will therefore ask leading questions about some of these meetings.

Q. Do you have in mind the meeting of the 24th day of September, 1945, of the Board of Directors, which I can further identify for you by saying it was the meeting at which the resignation of Joe Bernhard was acted upon by the [784-112] Board?

A. I have a distinct recollection of that meeting.

Q. You were present at that meeting?

A. I was.

Q. And voted on the resolution involving Mr. Bernhard?

A. Right.

Q. Do you remember whether at that meeting, in connection with that matter, there was any statement made by any person with reference to the reason why Mr. Bernhard was resigning from Warner Bros.?

A. It is my recollection that Mr. Bernhard—I asked Mr. Bernhard personally, and he told me he had three sons—I think three—and that he wanted to look to their future, and he thought that he would be a producer and that this sons would have a business that they could inherit.

(Deposition of Charles S. Guggenheimer.)

Q. Do you remember anything being said with reference to his entering into a business with Milton Sperling, the son-in-law of Harry M. Warner?

A. Yes. Whether, frankly, it was that meeting or before or after, I don't know, but I distinctly recall hearing that; the United States Pictures, I think, was the name.

Q. At that meeting the resignation of Mr. Bernhard as an officer and director of Warner Bros. was accepted?

A. It was. [784-113]

Q. You voted favorably to accepting that resolution?

A. I did.

Q. In connection with your vote, did any person state to you how you should vote or indicate a desire that you should vote one way or another on that motion?

A. No.

Q. In casting your vote, did you use your own independent judgment as to the matter?

A. Very definitely.

Q. I now call your attention to a meeting which was held three days later by the directors of Warner Bros., and when I say Warner Bros. I always mean Warner Bros. Pictures, Inc., at which you were present and at which there was presented a contract proposed to be executed between Warner Bros. and United States Pictures, Inc. Do you remember the occasion of that contract being presented to the Board?

A. I remember a meeting at which a contract was submitted, yes.

Q. Do you remember whether at that time there

(Deposition of Charles S. Guggenheimer.)

was anything said on the subject of the connection, if any, of Joseph Bernhard and Milton Sperling with United States Pictures, Inc.?

A. Yes, I think there was.

Q. What do you remember that was said on that subject? [784-114] What, if anything, in connection with it?

A. That they were United States Pictures.

Q. Do you remember whether the contract was explained by any person there? Were the terms of the contract stated by any person there?

A. Yes, I think they were. It is my impression it was Mr. Friedman who discussed it, stated the terms of it, and so forth.

Q. Do you have any recollection now as to what the terms in general were?

A. Very general. They were to make a certain number of pictures; the company was to—as I say, I am speaking completely from recollection; that is how long—six years ago, isn't it?

Mr. Pottish: That's right.

A. (Continuing): The company was to advance a certain part of the cost of the picture; they were going to make some bank loans or something, and the loaners were to get their money back before profits were taken, and then profits were to be divided in some way. Now, that is my recollection of the thing in general.

Q. Do you know whether at the time Mr. Friedman did explain the terms of the contract in detail?

A. I think he did, very definitely in detail.

(Deposition of Charles S. Guggenheimer.)

Q. After the matter had been discussed, it was voted [784-115] on. Did you vote favorably to authorizing the execution of the contract?

A. I did.

Q. At that time did you do so in the exercise of your own independent judgment on the matter?

A. I did.

Q. Did anybody state, directly or indirectly, to you, that you should vote in any particular way in the matter?

A. No.

Q. I call your attention to the fact that on the 23rd of November, of the same year, 1945, there was a directors' meeting held at which Mr. H. M. Warner was present, among others; at which there was presented a short letter agreement which constituted an amendment of the United States Pictures-Warner Bros. contract having to do with the one subject that the amount of any loans from banks should be deducted from the moneys payable to United States Pictures and turned over to the bank by Warner Bros. Do you remember the circumstances of that matter coming before the Board?

A. I will say yes. I remember several amendments of it. Dates I do not remember. There was this, and then I think there was even a subsequent amendment.

Q. That is correct. Now, as to this particular matter, the record of the meeting shows that it was resolved. [784-116] Did you vote in favor of that resolution?

A. I did.

(Deposition of Charles S. Guggenheimer.)

Q. And in doing so, did you exercise your own independent judgment? A. I did.

Q. Was there any statement made to you by any other person that you should vote in any particular way on that matter? A. No.

Q. Now I direct your attention to a meeting of the directors of Warners Bros. which was held on the 18th of June, 1946, the following year, at which there were present Mr. H. M. Warner and Jack Warner and Albert Warner and the other directors, including yourself—no, they were not all present; Albert Warner was present but not Harry or Jack.

Mr. Pottish: Excuse me, what was the date there, please?

Mr. Williams: This is the 18th of June, 1946.

Q. (Continuing) This is a meeting concerning a motion picture, the name of which was Pursued, and the proposal was that there should be an amendment to the basic United States Pictures-Warner contract with relation to that picture only. There was a writer named Niven Busch and an actress, a star, a motion picture star named [784-117] Teresa Wright, who was organizing a corporation known as Hemisphere Pictures, and they proposed to make a deal with United States Pictures which United States Pictures in turn would treat as a contract with Warners under the basic distribution and production agreement. Under the terms of this amendment, referring to this individual picture, Warners would receive only one-third of the net profit; on the other hand, the dis-

(Deposition of Charles S. Guggenheimer.)

tribution charge would be raised from the 20 per cent provided in the basic agreement to 25 per cent, and the amount of overhead would be increased.

Do you remember the discussion of that particular contract?

A. I remember the name of the picture Pursued. I do not remember the actual discussion in connection with it.

Q. Do you remember that at the time the matter was voted on there was some discussion and explanation of the matter to the Board?

A. Yes.

Q. And you voted, did you, in favor of that amendment? A. I did.

Q. In so doing, did you exercise your own independent judgment in your vote?

A. I did.

Q. Were you at that time directed or requested by any person to vote in any particular manner on that issue? [784-118] A. No.

May I just interrupt for just a moment to say this: At no time since 1932, when I have been on the Board, has anybody asked me to do anything in the way of voting or not voting, and if you go through all the records you will find that I have on some occasions voted diametrically opposite to the Warners and to everybody else. On one occasion, as I recall it, I was the only one who voted against it. I mean, I am glad to answer that each time, but that goes. They just have never asked me to vote.

(Deposition of Charles S. Guggenheimer.)

As a matter of fact, Harry Warner came to me and congratulated me on my independence.

Q. Mr. Guggenheimer, without the necessity of repeating it, we can regard it as being your testimony——

A. I am perfectly satisfied that you should; I am just calling your attention to it.

Q. We can probably save time. We can take it, then, that with reference to any meetings involved in this United States Pictures deal, that no person did make any suggestions, requests or directions as to how you should vote on any of the matters?

A. Definitely not.

Q. Now, I direct your attention to a meeting of the directors of Warner Bros. which was held on the 17th of August, 1950, and I recite, in order to refresh your [784-119] recollection about the matter, that on or about the 6th of December, 1947, there had been executed an agreement, which has been identified in this record as being the Exhibit No. 6 attached to the discovery proceedings on the 3rd of May, 1949, and that is an agreement which provided for the making of four additional pictures by United States Pictures. The original contract provided for the making of six pictures on the basis of Warner Bros. putting up half the cost, United States Pictures putting up half the cost, which they might borrow in whole or in part from banks, provided that after the banks had been paid and Warner Bros. had been paid, and after a distribution fee of 20 per cent had been deducted,

(Deposition of Charles S. Guggenheimer.)

and other expenses and costs had been recovered, that the net profits of each picture were to be divided fifty-fifty between Warner Bros. and United States Pictures. It provided for six pictures.

Now, on the 6th of December, 1947, as I have said, an amendatory agreement was executed which provided for the making of four additional pictures, or they were called additional pictures. Those pictures were to be produced on different terms: Warner Bros. was to put up the entire cost of production; the distribution fee was to be raised from 20 per cent to 25 per cent domestic; the British distribution was to be raised from 25 to 30 per [784-120] cent, and all of the other foreign was to be at 30 per cent; provision was made that Warners were to receive 80 per cent of the net profit and United States Pictures were to receive 20 per cent of the net profits. In all other respects the contract was to be subject to the terms of the basic agreement.

Then in 1950, on July 21st, a second amendment was made providing for the making of three additional pictures and extending the terms within which the pictures might be made. The last three pictures were to be produced on the same terms as the four additional pictures. By means of the series of contracts, that made a complete contract under which United States Pictures were to produce six pictures under the basic agreement, seven additional pictures, making thirteen in all, some of which had already been produced.

(Deposition of Charles S. Guggenheimer.)

Now, at this meeting of the 17th of August, 1950, this matter was brought before the Board of Directors, and I direct your attention particularly to the last page of the minutes of the meeting of that date, because the last page is the only portion that refers to this specific transaction, and ask you to read that. [784-121]

* * * * *

A. Yes, sir.

Q. Now, Mr. Guggenheimer, having had your recollection refreshed by what I have said and by reading the portion of the minutes referred to, referring to this matter, do you remember that at this meeting the matter was brought up before the Board of Directors, the matter of these additional pictures?

A. There was that matter brought up. I notice from the minutes—I am relying on the date of the minutes—I would say it was at that time. Frankly, I have no independent recollection of the date.

Q. You do have an independent recollection of the substance of the matter having been brought up?

A. I do, very definitely.

Q. Was that matter discussed by the Board members at that time? A. Yes.

Q. Thereafter a vote was taken, which, according to the minutes, acted favorably upon the amendment? A. That is right.

Q. Did you vote favorably to that matter?

A. I did.

Q. Was it your independent vote at that time?

(Deposition of Charles S. Guggenheimer.)

A. Definitely. [784-123]

Q. Do you remember what, if any, discussion was had, what matters were brought to your attention at that meeting before you voted?

A. You mean particularly did we discuss this contract?

Q. Well, that is what I had in mind. Do you remember if there was discussion of the contract?

A. Oh, very definitely.

Q. Do you remember what the particular discussion was?

A. Well, it was on an extension of time, wasn't it, to finish the pictures and also to make some new ones, and there were still some pictures unproduced on the original contract.

Q. You, at any rate, having heard the discussion, were favorable to taking that action?

A. I was.

Mr. Williams: You may cross examine.

Cross Examination [784-124]

* * * * *

Q. (By Mr. Pottish): Do you recall whether or not at the time you voted to approve the original agreement back on September 28, 1945, whether you then had an independent knowledge of whether the terms of this contract between Warner Bros. and United States Pictures were similar to the terms of other contracts with other independent producers that were working on Warners' lot?

(Deposition of Charles S. Guggenheimer.)

A. I did not know that it was similar or not. It seemed a fair contract.

Q. You say it seemed fair, but it would not be in the sense that it seemed fair in comparison with other contracts you knew about, would it?

A. I knew of no other contract at that time.

Q. At this meeting of September 28, 1945, do you [784-125] recall that either Mr. Friedman or Major Warner, or both of them, after either one or both explained the contract, recommended the contract as a good one?

A. I have no such recollection.

Q. Was it customary for a recommendation on an important matter, before a meeting over which one of the Warners was presiding, for the Warners to make a recommendation to the Board?

A. I do not recall ever having heard a recommendation from Major Warner. He has explained things, discussed them, talked over things, but when it comes flatly to say, "I recommend so-and-so," he may have, but I just have no recollection of it. [784-126]

* * * * *

Q. Sticking, if we may, to this August 17, 1950, meeting, had you prior to that time made any investigation on your own as to the administration of the contract as it had existed theretofore and how it was working out?

A. They explained to us, I believe, how many pictures [784-129] had been produced under it.

Q. Well, if I may be more specific.

(Deposition of Charles S. Guggenheimer.)

A. Or how many were still due, or something.

Q. Had you, to be more specific, made any independent investigation on your own as to how the contract was being administered with regard to how much overhead charges was being allowed to United States Pictures and how much overhead charges was being allowed to Warner Bros. and whether or not the charges or allowances might or might not be fair? Did you make any such investigation?

A. No. [784-130]

* * * * *

Q. Well, might I ask you if you ever actually inquired into the nature of the overhead charges that were being charged by United States Pictures to the operations under this contract?

A. No. All I tried to find out was, were they making money or were they losing money, and I understood they were making money on it.

Q. Just from the general viewpoint?

A. Yes, that is all that interested me—was the company getting a good deal? That's all.

Q. Were you familiar at the time as to the method provided under the basic contract between United States Pictures and Warner Bros. for the recouping of any losses by Warner Bros. on any one picture?

A. No, I wasn't.

Q. Would you say, Mr. Guggenheimer, that you would be willing to continue as a director in Warner Bros. Pictures at a forthcoming election of directors if it were against the wishes of the three

(Deposition of Charles S. Guggenheimer.)

Warner brothers that you be on the slate of directors for that election?

A. I think that the Warner brothers, who very largely control, could nominate or possibly succeed in nominating [784-132] somebody in my place. Whether they could, if I ran independently, whether they could succeed or not, you can guess as well as I can. I wouldn't know.

Q. Would you say that——

A. I would say that I would not, if I had a fight with them—I will go further than that and say I did resign once after an argument, when I disagreed, and I was told that I was there for the purpose of disagreeing if I felt that way, and please not to resign. I mean Harry Warner himself told me that.

Q. Is it a fact, Mr. Guggenheimer, that if you felt the three Warners no longer wanted you on that Board of Directors just prior to the election of a Board, that you desist from trying to become elected a member?

A. Well, now, just a minute. You are supposing here for a minute that I originally went on because the Warners love me. I didn't know them when I first went on; I went on because I represented about \$9,000,000 of debentures at that time and some seventy-five or a hundred thousand shares of the old stock, which is 200,000 shares now, and I still represent at this minute some fifty or sixty thousand shares. So that is why I am on the Board.

Q. Well, I appreciate that there is good reason

(Deposition of Charles S. Guggenheimer.)

for your being on the Board, Mr. Guggenheimer, but I still would like an answer, if I can get it, to my question. [784-133]

A. Well, you are asking me a question, would I stay on if the Warners didn't want me there. I would probably say no, unless my clients who own the shares would insist on my staying there, in which event I might make a fight. Don't forget, I do not represent the Warners directly, indirectly, or in any possible way; I have never—or any one of them. [784-134]

* * * * *

DEPOSITION OF MORRIS WOLF

Plaintiff's Exhibit No. 118: Deposition of Morris Wolf, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th St., New York, N. Y., on the 2nd day of June, 1951, at 10 a.m., before Julian Wolf, a Notary Public of the State of New York. [784-135]

* * * * *

Direct Examination

Q. (By Mr. Karp): Mr. Wolf, you are an attorney practicing in the State of Pennsylvania?

A. Yes.

Q. And how long have you been practicing law in that State? A. 48 years.

Q. And you are a member of the law firm there?

A. Yes.

(Deposition of Morris Wolf.)

Q. And what is the name of the law firm?

A. Wolf, Bloch, Schoor & Solis-Cohen. The last is one name with a hyphen between it.

Q. Your law firm handles the legal matters of Warner Bros. Pictures, Inc., in Pennsylvania and New Jersey, does it? A. Yes.

Q. That's a small part of the legal business of your [784-136] firm, isn't it?

A. It is a comparatively small part, yes.

Q. You are a director of Warner Bros. Pictures, Inc.? A. Yes.

Q. How long have you been a director of Warner Bros. Pictures, Inc.?

A. Since Warner Bros. acquired the Stanley Company of America in about 1929.

Q. And you made it a habit to attend the meetings of the Board of Directors of that corporation regularly? A. Yes.

Q. Now, do you recall having been present at a meeting of the Board of Directors of Warner Bros. Pictures, Inc., on September 28, 1945? And in order to identify that meeting, I will tell you that at that time there was presented to the attention of the Board a proposed agreement between United States Pictures, Inc., and Warner Bros. Pictures, Inc. Does that enable you to refresh your memory?

A. Not as to the date. I remember being present at the Board meeting at which that contract was presented.

Q. Now, do you recall who it was that presented

(Deposition of Morris Wolf.)

that proposed agreement to the attention of the Board at that time?

A. My recollection is that Mr. Friedman did.

Q. Mr. Stanleigh P. Friedman? [784-137]

A. Yes.

Q. And do you recall that he explained the terms and conditions of the proposed agreement?

A. I do.

Q. And do you recall that that agreement was unanimously approved by the Board at that time?

A. I do.

Q. And you voted for it? A. I did.

Q. And were you told or instructed by anyone how to vote on that occasion? A. No.

Q. You voted voluntarily? A. I did.

Q. Now, do you recall that in November of the same year there was another meeting of the Board of Directors of Warner Bros. Pictures, Inc.? And in order to identify that meeting I might say that it was purely for the purpose of amending the agreement to the extent of enabling Warners to set aside certain percentage of the moneys which ordinarily would have been due and owing to the United States Pictures, Inc., under the basic agreement, for the purpose of paying off loans that had been incurred by the United States Pictures, Inc.

A. I have a very vague recollection of that, Mr. Karp. [784-138]

Q. But do you remember having been present at the time?

A. I would not have remembered it, except from

(Deposition of Morris Wolf.)

refreshing my memory from a copy of the minutes.

Q. Yes.

A. I regard that as very formal—a pure formality and not of great significance, if I may be permitted to express a view.

Q. Do you recall having voted for the amendment at that time?

A. Well, I would not have recalled it, except that you refreshed my memory by calling my attention to the fact.

Q. Now, were you told by anyone how to vote on that occasion? A. Oh, no, no.

Q. Now, did you know prior to September 28, 1945, that Mr. Joseph Bernhard had resigned as a director of Warner Bros. Pictures, Inc.?

A. I did.

Q. Now, on June 18, 1946, there was a meeting of the Board of Directors of Warner Bros. Pictures, Inc., at which you were present. And in order to refresh your memory I have shown you a copy of the minutes of that meeting. Do you recall that at that time there was presented to the Board the proposed agreement between United States Pictures, Inc., and Hemisphere Pictures, with respect to the production [784-139] of a motion picture entitled Pursued? A. I do.

Q. And at that time a proposed amendment of the basic agreement between United States Pictures and Warner Bros. Pictures?

A. With respect to that picture?

Q. With respect to that picture.

(Deposition of Morris Wolf.)

A. Yes, I do.

Q. Do you recall having voted for the amendment? A. I do.

Q. And that it was unanimously carried by the Board? A. Yes.

Q. And again let me ask you, as I have previously asked you, whether the vote by yourself was voluntary. A. It was.

Q. And was it suggested by anyone?

A. No.

Q. Were there any instructions by anyone advising you how to vote at that time?

A. No.

Q. Now, do you recall that on December 6, 1947, an agreement was entered into between United States Pictures, Inc. and Warner Bros. Pictures, Inc., amending the basic agreement, extending the basic agreement, to 1951, and adding four pictures which were to be produced under that [784-140] agreement, also changing the agreement in the following manner: Warners was to advance 100 per cent of the costs. The profits, however, to be realized by Warners was to be 80 per cent instead of 50 per cent? A. I remember.

Q. By United States Pictures, 20 per cent?

A. I remember that that contract was made, but I don't remember when I learned that the contract was made. I don't think I knew it prior to the Board meeting at which the matter was discussed.

Q. Well, as a matter of fact, it wasn't presented to the attention of the Board in December of 1947,

(Deposition of Morris Wolf.)

but on August 17, 1950, there was a meeting of the Board of Directors of Warner Bros. Pictures, Inc., a copy of the minutes of which I previously brought to your attention, and at that time the agreement of December 6, 1947, was referred to?

A. That's right.

Q. Now, do you recall that it was also discussed by the Board at that time on August 17, 1950?

A. Well, I remember that the terms of the December agreement was then stated to the Board. I do not remember whether I had been familiar with those terms before that meeting.

Q. Well, now, do you recall that at that time on [784-141] August 17, 1950, another proposed amendment of the basic agreement was presented?

A. Increasing the number of pictures that were to be made and postponing the time for delivery, I remember that.

Q. And was that amendment carried by the Board? A. It was.

Q. Unanimously? A. Yes.

Q. And you, of course, voted for it?

A. I did.

Q. And that vote by you was voluntary and uninstructed by anyone? A. It was.

Mr. Karp: Your witness.

Cross Examination [784-142]

* * * * *

Q. (By Mr. Pottish): Did you have occasion,

(Deposition of Morris Wolf.)

prior to voting on the approval of that agreement, to study the agreement in full? A. No.

Q. Did you have occasion, prior to voting on that agreement, to have investigated the issue whether or not the agreement was the customary agreement between a moving picture company and an independent producer?

A. I have a general knowledge, after many years of being connected with the picture business, of the terms of independent agreement producing contracts, but I did not attempt to compare the individual paragraphs of this agreement with the individual paragraphs of other similar contracts.

* * * * *

Q. I believe you told us that with regard to the agreement of December 6, 1947, that first came to your attention at the meeting of the Board on August 17, 1950?

A. That's right, that is my present recollection.

* * * * *

Q. Do you feel, Mr. Wolf, that if the three Warner brothers at an ensuing election of the Board of Directors desired that you not be placed upon the next slate that you would not run or not be elected as a member of the Board?

A. I would feel that if they opposed my election, I could not force it, of course. [784-146]

* * * * *

Q. My point is, if Mr. Harry Warner alone—he is the president— A. Yes.

Q. —were to tell you that he no longer wished

(Deposition of Morris Wolf.)

your firm to represent Warner Bros. Pictures, why, that would be the end of it?

A. It certainly would, but I wouldn't limit that to Mr. Harry Warner. If anybody in authority told me they didn't want my services any more, I would, of course, acquiesce. [784-147]

* * * * *

Q. Well, did you exercise any surveillance over the administration of the basic contract or any of its amendments, particularly with regard to the questions of the items and amounts of overhead that were being charged by United States Pictures or being credited to United States Pictures?

A. No.

Q. You had no idea of what was happening in that regard? A. Not in that regard.

Q. Do you recall whether at the time you approved this agreement in 1945 that you were familiar with the fact that under its terms Warner Bros. could recoup a loss on any one picture only from the profits which might accrue on future pictures, and not from profits which might continue to roll in from all the pictures?

A. If I was familiar with it then, I have forgotten it now.

Q. You have no recollection now as to whether you knew that there was such a provision in this agreement?

A. I do not now have any such recollection.

* * * * * [784-148]

No. 14334

United States
Court of Appeals
for the Ninth Circuit

CHARLES B. SMITH, as Special Administrator
of the Estate of Edward S. Birn, Deceased,
Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER,
JACK L. WARNER, UNITED STATES
PICTURES, INC., and WARNER BROS.
PICTURES, INC., Appellees.

Transcript of Record

In Two Volumes

VOLUME II.

(Pages 293 to 595, inclusive)

Appeal from the United States District Court for the Southern
District of California, Central Division

FILED

NOV 30 1954

PAUL P. O'BRIEN,
CLERK

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(Pages 293 to 595, inclusive)

Appeal from the United States District Court for the Southern
District of California, Central Division

DEPOSITION OF ROBERT W. PERKINS

Plaintiff's Exhibit No. 119: Deposition of Robert W. Perkins, a witness called by and in behalf of the defendants, taken pursuant to stipulation dated May 2, 1951, at 321 West 44th Street, New York, N. Y., on the 21st day of May, 1951, before Murray Padgug, a Notary Public of the State of New York. [784-150]

* * * * *

Direct Examination

Q. (By Mr. Williams): What is your occupation, Mr. Perkins? A. I am a lawyer.

Q. Are you connected with Warner Bros. Pictures, Inc.?

A. Yes, sir. I'm general counsel for that company.

Q. And how long have you been general counsel for [784-151] the company?

A. Since 1936.

Q. Do you devote yourself in your professional work exclusively to the business of Warner Bros. Pictures, Inc., and its subsidiary and affiliated corporations? A. That is correct.

Q. Do you represent any one of the brothers Warner individually? A. No.

Q. Are you also a director of Warner Bros. Pictures, Inc.? A. Yes, sir.

Q. And you have been for how long a time?

A. I think the same length of time that I have been general counsel.

Q. Do you make it a practice to attend all of

(Deposition of Robert W. Perkins.)

the meetings of the Board of Directors, unless you happen to be out of town? A. I do.

Q. I call your attention to the minutes of a meeting of the Board of Directors of Warner Bros., held on the 25th day of September, 1945, simply for the purpose of directing your attention to that date, and I will say that those minutes indicate that on that date there was submitted to the Board and accepted by the Board the resignation of [784-152] Joseph Bernhard as vice-president and director of Warner Bros., and I may say when I use the expression "Warner Bros.", unless the context shows that I mean otherwise, I mean Warner Bros. Pictures, Inc. You were present at that meeting, were you not? A. Yes, sir.

Q. Having refreshed your recollection, do you remember that the resignation of Mr. Bernhard was accepted at that time? A. Yes, sir.

Q. At the time of the presentation of his resignation, was there anything said or any conversation had by any persons at that Board meeting as to why he was resigning?

A. He was resigning to go into production.

Q. Was there any more detail than that mentioned at that meeting?

A. Why, my recollection is that it was stated that Mr. Bernhard was going into partnership with Mr. Milton Sperling in the production of motion pictures, and that it was contemplated that those pictures would be distributed by Warner Bros. Pictures.

(Deposition of Robert W. Perkins.)

Q. Was anything said at that time as to who Mr. Sperling was? A. Yes.

Q. What was stated in that regard? [784-153]

A. That he was the son-in-law of Mr. Harry Warner.

Q. Was anything said as to what his experience had been? A. I think so.

Q. Do you remember in substance what was said on that subject?

A. Well, that he had been in the motion picture business for quite a while and had been a writer and a producer for 20th Century-Fox.

Q. I call your attention next to a meeting of the directors held three days later, on the 28th of September, 1945, at which time there was submitted to the Board a proposed contract between Warner Bros. and United States Pictures, Inc. I ask you to examine the minutes, refresh your recollection thereby, and then I will ask you some questions about.

A. (Reading) Yes, sir.

Q. You were present at that meeting?

A. Yes, sir.

Q. Do you remember that at that meeting a resolution was adopted authorizing the execution of the contract that I have just described?

A. Yes, sir.

Q. Do you remember what if anything was said of and concerning that contract, its terms and provisions and by [784-154] whom, prior to the action of the Board?

(Deposition of Robert W. Perkins.)

A. Well, I remember that the contract was discussed at some length. I am quite sure Albert Warner was presiding, and my recollection is that he brought up the matter, and Mr. Friedman had with him a copy of the contract, and that after perhaps introduction of the matter by Major Warner, that Mr. Friedman analyzed the contract for the benefit of the Board members.

Q. Do you remember now any of the details of that contract?

A. No, except that it was a contract of what I suppose should be described as the general type under which an independent producer—in this case, United States Pictures, Inc.—would make a picture and turn the picture after completion over to the company for distribution on a percentage basis. I remember that the pictures were to be made on the Warner lot, and I think the pictures were to be financed in part by United States Pictures and in part by Warner Bros. Pictures. There was a percentage for distribution, and after the recoupment of the cost from the remaining proceeds of the picture, then, still deducting the percentage, the remaining proceeds were to be split between United States Pictures and Warner Bros. Pictures.

Q. Do you remember the percentage of the split? [784-155]

A. It was fifty-fifty.

Q. Do you remember that that contract was in some detail explained by Mr. Friedman?

A. I'm sure it was.

(Deposition of Robert W. Perkins.)

Q. Do you remember having noted any particular provision or provisions that at the time struck you as being unfavorable or unsatisfactory from the standpoint of the company?

A. No, sir.

Q. Subsequent to the explanation of that contract and at the time the Board approved it, did you vote favorably on the approval of the contract?

A. Yes, sir.

Q. Had you also voted favorably on the resignation of Mr. Bernhard at the meeting before that?

A. Yes, sir.

Q. Was your vote in either of these instances suggested or directed by any person other than yourself? A. No.

Q. Did you exercise your own independent judgment in voting on both of these occasions?

A. Yes.

Q. I direct your attention now to a meeting which was held on the 23rd of November, 1945, and in order to refresh your recollection as to that meeting, at which the [784-156] minutes show you were present, I will call your attention to the fact that at that meeting there was submitted an amendment to the basic agreement referred to at the last meeting, which provided in effect that from the proceeds of the distribution of any pictures made under the terms of that basic agreement, that Warner Bros. should retain and turn over to the bank which was making a loan to United States

(Deposition of Robert W. Perkins.)

Pictures such sum as was necessary to pay that loan or loans.

Do you remember the circumstances of that meeting?

A. I remember that there was a meeting some time after this meeting in December.

Q. I will show you the minutes.

A. —which had to do with—excuse me—some problem with the arrangement with the bank.

Q. Do you now remember having examined the minutes as to just about what that particular problem was?

A. Frankly, no, Mr. Williams. I remember that I did not consider that it was a very important change.

Q. You voted in favor of it? A. I did.

Q. Did anybody direct or suggest the manner in which your vote should be cast on that?

A. No.

Q. Your vote was the result of your own independent [784-157] thought, in view of your then knowledge of what was proposed by the amendment? A. That's correct.

Q. And you do not now remember the details of that particular amendment?

A. No, sir.

Q. I direct your attention to a meeting of the directors held on the 18th of June, 1946, which had to do with an amendment to the contract with reference to a single motion picture to be produced under the contract, which picture was entitled

(Deposition of Robert W. Perkins.)

Pursued, and in order to refresh your recollection of the matter, I direct your attention to the fact that picture involved a third corporation, Hemisphere Pictures, which was a corporation in which there were the author of the screen play, Niven Busch, and the proposed star of the picture, Teresa Wright, who were to be stockholders, and under the terms of which Warner Bros. would receive only one-third of the net proceeds, and the other proceeds would be divided between the Hemisphere Pictures and United States Pictures, but Warner Bros. would receive a higher percentage for distribution; that is, instead of getting twenty per cent domestic, it would be twenty-five per cent domestic, and more for foreign, and also that Warner Bros. would receive a higher rate of overhead [784-158] on its facilities.

Do you remember that meeting? I will show you the minutes or a copy of the minutes so that you may refresh yourself as to the date and as to who was present and as to what was done there.

A. Yes, sir. I remember that there was a meeting which acted on the matter of amending the contract with United States Pictures so as to provide for a picture in which a company called Hemisphere Pictures or some such name was to produce or to participate in the production.

Q. Do you remember what reasons, if any, were stated as to why Warners should reduce its participation in the net profits from one-half to one-third in that particular case?

(Deposition of Robert W. Perkins.)

A. In general, yes. The—It was felt that the picture which was to be produced would be a valuable one, because of Busch, the writer, and Wright, the star. United States Pictures and Warner Bros. Pictures could not get the picture except on terms under which Hemisphere would produce the picture or participate in the production and would share in the profits; and the amendment which was laid before the meeting was the result of the negotiations with Hemisphere to that end; and my understanding is that the sharing arrangement, both of Warner Bros. Pictures, Inc. [784-159] and of United States Pictures, was reduced in order to meet the demand of Hemisphere, that that company also should participate.

Q. You voted in favor of that amendment, did you not? A. Yes, sir.

Q. Did any person suggest or direct how you should vote? A. No.

Q. Was your vote the result of your own independent judgment? A. Yes.

Q. And in your opinion was it for the benefit of Warner Bros. that you should have voted as you did on that and on the previous occasions?

A. Yes.

Q. I direct your attention to a letter-contract dated December 6, 1947, which was executed on behalf of Warner Bros. by R. J. Obringer, and which did not come before the Board for approval or action at that time; in fact, was not brought to the attention of the Board officially until 1950.

(Deposition of Robert W. Perkins.)

I ask you to examine the photostatic copy I have of this contract and, having examined it, I will then ask you some questions.

A. (Reading) All right. [784-160]

Q. I call your attention to the fact that by the terms of that contract provision is made for the selection by United States Pictures of four pictures, which are designated in the contract as "additional pictures," and as to those additional pictures Warner Bros. are to advance the entire cost of production; that the distribution fee is to be raised from twenty per cent domestic to twenty-five per cent, and from twenty-five per cent British to thirty per cent, and various percentages for other foreign distribution; that the provision is made that a higher rate of overhead is to be charged for Warner's facilities to be used in the making of the pictures, and that the net profit from the distribution of the picture, after recoupment of all costs and distribution charges is to be divided eighty per cent to Warner Bros. and twenty per cent to United States Pictures.

Having that in mind, do you remember the circumstances of that amendment being brought to the attention of the Board?

A. No, I don't, Mr. Williams.

Q. Were you present at that meeting——

Mr. Pottish: Might I say at this point——

Mr. Williams: Just a minute. You are right. There wasn't any meeting, I withdraw that last question.

(Deposition of Robert W. Perkins.)

Q. You do not remember it being brought to the [784-161] attention of the Board?

A. Well——

Q. Pardon me. Were you aware of the fact——

A. Excuse me. You asked me about it being brought to the attention of the Board, the circumstances under which it was brought to the attention of the Board. That I don't remember. It is my recollection that it was brought to the attention of the Board at some time.

Q. Yes. I will ask you this: whether at or about December 6, 1947, it came to your knowledge that such a contract had been executed by Mr. Obringer on behalf of the corporation.

A. I do not recollect when, but it did come to my knowledge.

Q. Do you remember whether or not prior to any meeting of the Board in reference to it, it did come to your attention?

A. In all probability, yes.

Q. You do not remember specifically as to when it did come to your attention? A. No.

Q. I direct your attention to a meeting of the Board of Directors that was held on the 17th of August, 1950, at which a resolution was adopted, which appears on the last page of the minutes, and I ask you to examine [784-162] the minutes and particularly that last page, and thereby refresh your recollection as to that matter.

A. Yes, sir.

Q. Having refreshed your recollection by exam-

(Deposition of Robert W. Perkins.)

ining the minutes of that meeting, will you state as to whether you were present at the meeting.

A. I was present.

Q. Do you remember the circumstances of this second amendment, with reference to three more additional pictures having been brought before the Board?

A. That's the one dated July 21, 1950, if I remember correctly?

Q. Yes.

A. Yes. I remember that the Board was told that it was proposed to amend the United States Pictures agreement further by providing for additional pictures and for the extension of time for delivery.

Q. Do you remember that it was also pointed out that as to these additional pictures, Warner Bros. would finance the making of each of the pictures, and that it would receive a domestic distribution rate of twenty-five per cent, and British and other foreign of thirty per cent, and various other rates, and that after recoupment of the distribution charge and the entire cost to Warner Bros., that the profits would be divided *eight* per cent to Warner Bros. [784-163] and twenty per cent to United States Pictures?

A. That's my recollection.

Q. Do you also remember that it provided for a rate of overhead as to Warner's facilities that was higher than that provided by the basic agreement?

A. That is my recollection.

(Deposition of Robert W. Perkins.)

Q. You understood that at the time you voted on the amendment? A. Yes, sir.

Q. Did anybody suggest or direct how you should vote on that matter? A. No.

Q. Was your vote the result of your own independent judgment? A. Yes.

Q. You regarded the amendment to the contract as being for the benefit of Warner Bros.?

A. Yes.

Q. You voted in favor of that amendment, then, I take it? A. Yes.

Mr. Williams: I have no further questions.

* * * * * [784-164]

Cross Examination

Q. (By Mr. Pottish): Mr. Perkins, is it your understanding that the three Warner brothers could, if they wished, caused a termination of your position as general counsel to the company?

A. Only if I acquiesced in their decision, Mr. Pottish. I—each year I have been elected general counsel by the directors, and I would not think that the three Warner brothers could terminate that relationship without the approval of a majority of the directors.

On the other hand, if your question is meant to cover the further question as to whether I would remain as general counsel over the opposition of the three Warner brothers, that is a different matter.

Q. Would you, Mr. Perkins?

(Deposition of Robert W. Perkins.)

A. Remain as general counsel?

Q. Yes. A. No.

Q. And would you remain as a director for the ensuing year over the opposition of the three Warner brothers?

A. I couldn't answer that question without knowing the circumstances under which it arose, Mr. Pottish. After all——

Q. Do you feel they have enough influence by themselves [784-165] with the Board, at the next election of the Board, if they so wished, to keep you off the Board of Directors?

A. Well, I'm elected, of course, by the stockholders for a term of two years. Our terms run two years. And I'm nominated by the Board of Directors to be a director. Unquestionably, the Warners have considerable influence with the Board.

The former question was directed to the problem as to whether I would remain as a director if asked by the Warners, and I told you frankly that I would have to know the circumstances, because I hold office as a director under mandate from the stockholders.

Q. My point is, Mr. Perkins: If at the end of your term the three Warner brothers desired to see to it that you were not nominated for the ensuing term, do you think that they could succeed in keeping you off the slate going before the stockholders?

A. I don't know. I don't know. Whether I would be a candidate is an entirely different question.

(Deposition of Robert W. Perkins.)

Q. Would you be a candidate against their wishes? A. I don't think I would.

* * * * * [784-166]

Q. At that time, were you familiar with the facts as to whether or not Warner Bros. Pictures had ever made a similar contract with any other independent producer prior to that date?

A. Oh, I'm sure that we had made contracts with independent producers prior to that date, and subsequent to that date; and I'm sure that we've made contracts of the same general type.

Q. I am afraid I did not get my question clear. I understand that other contracts have been made by Warner Bros. with other independent producers, both [784-169] before and after that contract of September 28, 1945, but my question is: Did you know at that time, September 28, 1945, whether with regard particularly to United States Pictures, the United States Pictures contract and the particular terms in that contract regarding such things as financing or recouping of losses and the method of financing and the share of profits, the Warner Bros. had ever made a similar contract with another independent producer which was as favorable or more favorable to the independent producer?

A. I certainly believed at that date that the contract which had been negotiated with United States Pictures was in general the same as contracts which have been negotiated with other independent producers. * * * * * [784-170]

Q. Did you at or prior to the meeting of Sep-

(Deposition of Robert W. Perkins.)

tember 28th, make an independent investigation as to whether or not the provisions of the United States Pictures contract was or was not more favorable to the independent producer than the provisions of other contracts with other independent producers?

A. No; not an investigation in the sense of looking up records and talking to people.

Q. Did Major Warner at that meeting of September 28, 1945, state that it was the recommendation of both his brothers on the Coast and himself that the contract was a good one for the company?

A. Yes. * * * * * [784-172]

Q. With regard to that amendment, presented to the Board on August 17, 1950, by whom was that amendment presented to the Board?

A. That I don't remember. [784-174]

Q. That amendment to the basic contract: Had you seen that amendment prior to the meeting of the Board itself?

A. I don't remember.

Q. Do you remember whether or not, prior to voting on the approval of that amendment, you had made an independent investigation of whether or not the amendment was a good one or a fair one to the company?

A. No. I didn't make an independent investigation.

Q. Is it fair to say that with regard to your voting on that amendment, you relied upon the judgment and recommendation of those people who

(Deposition of Robert W. Perkins.)

were in charge of that phase of the company's business? A. Yes.

Q. Did you at any time, Mr. Perkins, exercise any surveillance over the administration of either the basic agreement of September 28, 1945, or any amendments thereto? A. No.

Q. Did you at any time cause anybody on your behalf, or did you yourself look into the matter of the various charges and credits which were being offered either on behalf of Warner Bros. or United States Pictures in their respective accounts under this agreement and the amendment thereto?

A. No, sir. * * * * * [784-175]

DEPOSITION OF JACK L. WARNER

Plaintiff's Exhibit No. 121: Deposition of Jack L. Warner, a defendant in the above-entitled action, taken on behalf of the plaintiff, at 3:00 o'clock p.m. on Friday, March 16, 1951, at 4000 West Olive Avenue, Burbank, California, before William H. Burgess, Jr., a Notary Public within and for the County of Los Angeles and State of California, pursuant to the annexed Stipulation. * * * * *

Jack L. Warner, a defendant herein, having been first duly sworn, deposed and testified as follows:

Direct Examination

Q. (By Mr. Lyon): Mr. Warner, I presume you have had your deposition taken several times before? A. Yes, I have.

(Deposition of Jack L. Warner.)

Q. You realize that you are under oath and will be testifying the same as you would if you were a witness in court? A. Yes.

Q. And you will have the opportunity to go over the record made of my questions and your answers and make any corrections that you deem necessary.

On the other hand, we will have the right to question you regarding any corrections that you have made.

A. Yes, I understand.

Q. What is your position with Warner Bros.?

A. I am vice president in charge of production.

Q. How long have you held that position?

A. Ever since the incorporation of the company; since 1923.

Q. Have you been a director all of that time, too? A. I have.

Q. Are your duties performed mainly in California? A. Yes, they are.

Q. Has that been so from the inception of the company? [784-178] A. Yes, it has.

Q. Do you perform any duties outside of the state?

A. Very little. What do you mean by "duties"?

Q. In connection with the corporation.

A. Yes. I am in charge of making films in London, the last few years since the quota laws of Great Britain; I supervise that work.

Q. You are in charge of making films, wherever the company makes films; is that right?

(Deposition of Jack L. Warner.)

A. Yes, virtually.

Q. Your major production is here in this studio in Burbank? A. Yes.

Q. Beginning in about 1945, what proportion of your production has been in this studio?

A. I believe all at that time. Yes, it was; all of it was here then.

Q. When did you start production in places other than the Burbank Studio?

A. It has only been just three or four pictures in England, the last couple of years.

Q. Will you explain in a little more detail what the nature of your duties is, being in charge of production?

A. I purchase, pass on the purchasing of, stories and plays and novels. I engage the producers, the important [784-179] stars, artists, the top artists, the top directors, do the reading of the scripts, for the preparing of them for the final production, and then, in cooperation with the producer and director, supervise the editing of the films, up to their final readiness for exhibition. Or I turn it over to our laboratory. That is the best way to put it.

Q. Do you perform those duties in regard to all of the films that are produced here in the Burbank studio?

A. All the pictures produced by our corporation, yes.

Q. Does that include the pictures produced under contracts with independent producers?

A. With some I do, and some I don't. Some of

(Deposition of Jack L. Warner.)

the time, myself and others. I help everybody, in one form or another, whether I have the autonomy or not.

Q. How do you determine the extent of your help in connection with independent producers?

A. I haven't any yardstick. Just questions asked; and I go to their previews and help them on what they call editing the picture. You know, removing scenes or adding or retaking scenes, or if photography should be bad, I suggest that they remake some scenes. When they have their own autonomy, of course, it is not mandatory on their part. It is just voluntary, free advice I give them.

Q. Which independent producers have their own autonomy? A. You mean now? [784-180]

Q. Now, that are producing now.

A. Right now there is William Cagney Productions, Norma Productions, which make pictures with Burt Lancaster, Alfred Hitchcock, and the United States Pictures. That is the four that are producing, I believe. I think that is all right now.

Q. In those the help is voluntary on your part; is that correct?

A. Yes, sort of. They take advantage of my experience, gratis.

Q. You spoke of United States Pictures; that is the company in which Milton Sperling is president?

A. I believe he is president, yes.

Q. When did you first know Milton Sperling?

A. I have known Milton Sperling for over 20 years. He worked here at this studio, and then he

(Deposition of Jack L. Warner.)

left, and the next—I watched his career, especially at 20th Century-Fox, where he produced quite a number of very important pictures, all with very top stars, and I imagine very successfully.

Q. Do you know what pictures he produced at 20th Century-Fox?

A. Offhand, *To the Shores of Tripoli*, a big technicolor picture, which was a fabulous success; *Hello, Frisco, Hello*, with Betty Grable, which I am pretty sure was a hit; [784-181] and there was one I saw with Tyrone Power—I forget who the rest of the cast was—called *Crash Dive*, a submarine picture.

I think all of them were in color, and they are pretty vivid in my mind.

Several others; I could tell you, if I could just look at a memo I made on just exactly what the pictures were.

Q. Will you do that?

A. Yes. One called *Hot Spot*, with Betty Grable; *Rings on My Fingers*. I forget who was in that now. Another one was with Sonia Heinie, called *Sun Valley Serenade*, a big hit. Those are the six top pictures. He may have made more, but I don't remember them. I do remember these top pictures.

Q. You have been referring to a memo; did you just make that recently?

A. No, I have been jotting this down for a long time, off and on.

Q. Over what period of time?

A. Two or three or four years, off and on. In

(Deposition of Jack L. Warner.)

fact, I found this little memo somewhere among some papers, a couple of days ago, going through the drawer. I may have made this at the time we were going to engage him, make the [784-182] deal with him.

Q. I was going to ask you, was that made at that time or was it made subsequent to that time?

A. I wouldn't want to say it was made since or before. I made it for one reason, just to bring fresh to my mind the pictures he had produced, and credit for such. That is all there is to it. It isn't any usual memo, just a small piece of paper.

Q. When did you first know that Warner Bros. was considering entering into a contract with Milton Sperling, for him to act, either individually or through a corporation, as an independent producer?

A. The first I heard of it was, as I say, around in 1945. I can't remember the exact dates, but my brother told me about it. Milton had come back from being in the Marines at the time, and he said he was going to go back to Fox, or some company he was going back with, and would we be interested? I said yes, if we could make the proper deal for the corporation, we would be happy to make the deal with him, because we were looking for manpower. I, too, had just returned from the Air Forces. I had been to Europe, came back fresh in mind, and held a big meeting with all our producers, directors and executives, and told them we have to get manpower to make pictures.

I could see ahead that there was going to be hard

(Deposition of Jack L. Warner.)

[784-183] sledding to get the right manpower to produce pictures, and everything I predicted then has been true, right up to this very day. It is very hard to get the right people to produce pictures.

Q. When you had that conversation with your brother, was that before the corporation United States Pictures was formed?

A. I don't know. I wouldn't know.

Q. It was before the contract was signed between United States Pictures and Warner Bros.?

A. It must have been, because my brother talked to me about it.

Q. Were you in New York at the time the board of directors approved the contract between Warner Bros. and United States Pictures?

A. I believe not, although I am not sure. I feel certain that I wasn't, but I am not positive. The record would have to show that.

Q. What I am trying to do is find out if you place the time in your mind, about when that contract was signed or approved.

A. All I know is, around six years ago, in 1945, or something like that. I couldn't tell you the exact time.

Q. Would you know about how long before it was signed, if it was before it was signed, that you discussed [784-184] with your brother the propriety of entering into such contract?

A. No, I don't know. The time would be hard to place, at this late date. All I know is that we

(Deposition of Jack L. Warner.)

made the deal with the man for a good purpose, for the corporation.

Q. Is it true that most of the contracts with independent producers are originally instituted, or instigated, by you?

A. There isn't any set pattern. My brother may have talked to some of these independent men, or I may have. I would be the one who would conclude the deals, yes, but who started the deals I couldn't tell you. We made many independent producing deals.

Q. Did you conclude the deal with Milton Sperling and his corporation, in this instance?

A. No, I didn't. When I say "conclude," I mean I stated it would be a very good thing to have any good independent production company here who could make profits for the company, or attempt to make profits, because you don't always make profits in making pictures, you know.

Q. Who worked out the terms of the agreement between Warner Bros. and United States Pictures, if you know?

A. I don't know who worked with that, I really don't.

Q. Did you go over the terms of the agreement, at any time prior to the time it was signed?

A. Yes, I went over the terms of that contract, the same as I do with every other contract.

Q. Would you say that you concluded that contract as you did the other contracts with independent producers?

(Deposition of Jack L. Warner.)

A. I would say that I was equally responsible in concluding that, as well as any other one, yes.

Q. With whom did you discuss the terms of the proposed contract?

A. I talked with our attorneys; whether in the presence of my brother or not I just can't remember. Probably he was there; I don't know.

Q. Did you discuss it with Milton Sperling?

A. No doubt I did, yes; I am sure I did.

Q. Do you remember discussing it with Milton Sperling now?

A. No doubt I did. I can't remember exactly, but I would say I did.

Q. Did you discuss with him the proportion of the cost that would be borne by each of the companies?

A. Whatever the contract states, I discussed. Terms and conditions of the contract—as you no doubt have a copy of it—tells the story that I discussed. * * * * * [784-186]

DEPOSITION OF HARRY M. WARNER

Plaintiff's Exhibit No. 122: Deposition of Harry M. Warner, a defendant in the above entitled action, taken on behalf of the plaintiff, on Wednesday, November 8, 1950, at 2:00 p.m., at 4000 West Olive Avenue, Burbank, California, before John B. Hos-sack, a Notary Public within and for the County of Los Angeles and State of California, pursuant to the annexed stipulation. * * * * *

Harry M. Warner, having been first duly sworn, deposed and testified as follows:

Direct Examination

* * * * * [784-210]

Q. (By Mr. Lyon): Now, will you state your position with the Warner Bros. Pictures, Inc.?

A. I am president.

Q. How long have you been president?

A. Since its inception; '23, I think it was, 1923.

Q. Are you also a director? A. Yes, sir.

Q. How long have you been a director?

A. For the same time.

Q. Are you also a stockholder?

A. Yes, sir.

Q. How much stock do you hold?

A. Personally?

Q. Yes. A. At this time?

Q. Yes.

A. Oh, maybe 350 or 400,000 shares. I don't now exactly what.

(Deposition of Harry M. Warner.)

Q. Now, in September of 1945, did you hold approximately the same number of shares?

A. I would say as much or more. I don't remember exactly.

Q. And you have held approximately that number of shares since August and September of 1945?

A. Well, I would have to recall when we doubled up the shares. I am speaking numerically.

Q. Yes.

A. We doubled the stock of the company and gave a share for each share held.

Q. In other words, at some time you issued two shares for each share held by the stockholders?

A. I believe so. [784-212]

Mr. Freston: May I answer that?

Mr. Lyon: Yes.

Mr. Freston: There was a stock split up some time ago, and that simply increased the number of shares outstanding without changing the relative value of the shares as a whole.

Q. (By Mr. Lyon): Then, Mr. Warner, your proportionate number of shares has remained approximately the same since 1945?

A. Yes, sir.

Q. Where do you maintain your offices as president of Warner Bros.?

A. Here; New York.

Q. Approximately what part of your time is spent here and what part in New York?

A. Well, that I can't tell you at this moment. It

(Deposition of Harry M. Warner.)

used to be at one time more in New York than here, and of late it is more here.

Q. When did that change take place?

A. When the troubles in business come in, why, my spot changes.

Q. And since 1945 has the amount of time that you spend here increased or decreased?

A. Well, it is about the same; it has been since about '36 or '37.

Q. Would you say that you had divided your time [784-213] rather equally between your New York and Burbank office?

A. Well, I would just be guessing. It all depends where it is required, mostly.

Q. What are the general nature of your duties as president?

A. To guide this company, to make money, to be successful.

Q. Do you do any of the guiding in connection with the production of pictures?

A. It depends on what part; as to the cost of pictures, yes, and discuss what to make. We have to do that possibly a year or two in advance. You can't start and decide you are going to make a picture and turn it out the next week, put it out. It takes sometimes two or three years.

Q. Do you supervise or discuss the making of contracts to produce pictures?

A. Yes, sir.

Q. And——

(Deposition of Harry M. Warner.)

A. (Interrupting): Did you get that answer, sir?

Q. Yes.

A. Yes. Some; now, I won't say all. Now, wait a minute. I discuss contracts for the purpose of making pictures, but I wouldn't say that I discuss all. There may be a picture made here or there that I don't.

Q. I see, but if you could state a general rule, [784-214] you generally supervise the making of the contracts that result in the production of pictures?

A. The principle, yes; the principles of it.

Q. How long have you been in the motion picture business? A. 45 years.

* * * * * [784-215]

Q. (By Mr. Lyon): Now, are you generally familiar with the date that United States Pictures, Inc., was incorporated?

A. No, I don't know.

Q. Would it refresh your recollection, that it was incorporated in August of 1945?

A. If you would say so, I would take it for granted.

Mr. Lyon: Is that correct, Mr. Schwab?

Mr. Schwab: Well, I don't have the exact date here, Mr. Lyon. We furnished it to you in the interrogatories.

Mr. Lyon: Yes, that was the date in the interrogatories.

Mr. Schwab: Well, then, that is correct.

Mr. Lyon: All right.

(Deposition of Harry M. Warner.)

Q. Now, prior to August of 1945 or prior to the formation of United States Pictures, Inc., did you discuss with Mr. Sperling the prospective formation of a corporation to produce pictures?

A. Well, I didn't discuss so much with him any formations of any corporation except that I discussed with him about coming with this company.

Q. When did that discussion take place?

A. I would say about when he came back from the [784-221] Marines, when he was discharged, after his discharge from the Marines.

Q. Where did that discussion take place?

A. Well, that I couldn't tell you, but I could tell you what caused it.

Q. Will you do that?

A. If you would like to know what caused it, I haven't any objection in telling you. There was a doctor by the name of Sam Hirshfeld, since deceased, who was my personal doctor and my brother Jack's. He came in to this room one day and said: "Well, we just carried your brother out of here," and he says, "Now, I would advise you to do something about it, because he is a pretty sick man. We have been carrying him out of here quite a few times. He is overworked, and what the ultimate result may be, we don't know." So, it was then that it occurred to me that I had better start in finding someone in whom I had enough confidence that I would want to develop into a position of my brother to operate this studio; because I certainly couldn't do it. It was then that I looked around

(Deposition of Harry M. Warner.)

and thought, "This young man has ability, and I would prefer him—I would have more confidence in him than in any one else in that position."

Q. What did you do to satisfy yourself that he did have the competency to take over that position?

A. What did I do?

Q. Yes.

A. I went about trying to get him.

Q. What did you do to make the determination that he was of that competency?

A. My own judgment.

Q. What had you seen him do that made you form that judgment?

A. Well, I have passed judgment on many a man without seeing him do anything. I have passed judgment on a man's ability by the things that he had done.

Q. What had he done that you took into consideration?

A. Well, I would have to get you an analysis of it.

Q. Was it based upon work that he had done in motion pictures?

A. In motion pictures, yes, sir. I don't know anything about him outside of in motion pictures and his career with the Marines. That is about all that I know.

Q. Was that work that he had done in motion pictures for Warner Brothers or work that he had done in motion pictures for 20th Century-Fox?

A. 20th Century-Fox mostly.

(Deposition of Harry M. Warner.)

Q. How did you familiarize yourself with what he had done for 20th Century-Fox?

A. I know the business pretty well. When somebody [784-223] has ability, I am able to judge. I have so far done pretty well in my judging.

Q. Did you judge by viewing the pictures with which he was connected, or—— A. Yes.

Q. (Continuing) ——by talking to Mr. Sperling, or how?

A. Talking to Mr. Sperling, viewing the pictures, talking to others, talking to Mr. Skouras. There are three Skouras'; so, let's not get mixed up with the three. This is Spiros Skouras I am talking about, the president of 20th Century-Fox.

Q. Did you determine——

A. (Interrupting) Pardon me. I explained to Mr. Skouras my problem, and there was no use my going any further and thinking about it unless I could get him freed from 20th Century-Fox, with whom he had a contract and who was trying to get him to sign a new contract for a number of years.

Q. Did you ascertain at that time what remuneration he was receiving from 20th Century-Fox?

A. Yes, I did; yes. As I recall, I think he was getting \$1,250 a week, and they were trying to get a new contract with him for twice that much.

* * * * * [784-224]

Q. Now, when did you first discuss with Mr. Sperling your plans for him?

A. At that time.

(Deposition of Harry M. Warner.)

Q. Would that be before the corporation, United States pictures, Inc., was incorporated?

A. Oh, yes, quite a time before.

Q. And would that be a number of months before or longer?

A. Oh, I think it was quite a time. If I was asked to the best of my recollection, I would say it was not less than eight months; maybe longer than that.

Q. Now, did you have any discussions then with Mr. Sperling as to how you would work out your plans for him?

A. I had no discussions with Mr. Sperling about how he was to work for us or what he was to do until I was assured that 20th Century-Fox would let him go. [784-225]

Q. I see.

A. Because I understand there was quite a battle there; that is, I was told that they didn't want him to go.

Q. After Mr. Skouras gave the release, then did you discuss with Mr. Sperling what the arrangements would be between him and Warner Brothers?

A. We discussed from time to time how we could go ahead and get something together that could bring him in with this company, with the understanding that if some misfortune should happen, that he would be able to take over my brother's place, relieve me of that responsibility.

Q. Were those discussions between Mr. Sperling

(Deposition of Harry M. Warner.)

and yourself alone, or were others present when they took place?

A. Oh, I couldn't tell you. There were quite a number of discussions pertaining to a business deal.

Q. And that would be discussions over a period of several months?

A. I would imagine, as I recall.

Q. Now, during those discussions, was it discussed whether he would come in on a salary or as an independent producer?

A. Well, now, that was in my own mind in order to develop a man to have—to occupy the position that I would want him to occupy here, take the place of my brother. I felt that he ought to get a good experience, a business experience, without just writing stories or making pictures. [784-226] The motion picture business is no different than any other business; you have to have business experience in addition to the knowledge of making a picture; and then when I found that I could get him loose, I set about to see how I could get a good business man to hook up with him and get him an experience that a man in that kind of a position would require, and I got him Joe Bernhard. Now, Joe Bernhard was the man that I brought into this business from the real estate business and taught him how to operate our theatre business. And in particular, in those days, he needed a lot of teaching, because business was bad, plenty of debts—I don't know how much—a hundred and fifty, sixty or

(Deposition of Harry M. Warner.)

eighty million. You had to meet the payrolls, you know, and the expenses.

Q. Yes.

A. So that I had trained Mr. Bernhard, until one day I said, "You go ahead from here on and run that end of the business." I thought that the combination of Sperling as a producer and Bernhard as a business man would be a good combination to learn what this was all about.

Q. Yes.

A. You could have the best producing man in the world right here to make pictures, but you need a little more than that.

Q. Now, did you discuss with Mr. Bernhard the [784-227] possibility that he would join forces with Mr. Sperling to have this independent producing company? A. Yes, sir.

Q. Did you discuss that with Mr. Bernhard prior to the actual formation of the corporation, United States Pictures?

A. Yes, sir; because Mr. Bernhard, you must remember, had a pretty good job with us. I think he was drawing \$3,000 a week, and bonus; and when you ask a man to give up a position of \$3,000 a week and a pretty good bonus, why, you naturally discuss it with him. Now, the thing that I was interested in was that I myself wasn't so well. You see, I had been in the hospital a few times myself and I wasn't as healthy as I was, and I was looking to create a combination to take the place of even myself.

(Deposition of Harry M. Warner.)

Q. Did you discuss this with Mr. Bernhard over perhaps a period of six months prior to the actual formation of the corporation, too?

A. I don't remember how long, but we started in slowly and developed the talks.

Q. Were those talks generally between the three of you; that is, yourself, Mr. Bernhard and Mr. Sperling?

A. No; I discussed this thing with each one at first separate, because it was the only way I could do it.

Q. Yes. [784-228]

A. And then I brought them together to see if the two could work together. That was the big problem.

Q. Then as you discussed it with them, either separately or together, did you discuss whether it would be an independent producing venture rather than their acting as employees of Warner Brothers?

A. I discussed with them that they should start in the best way that they could get the most education in the operating and the operation of a business of that type; because you must bear in mind that Mr. Bernhard was not familiar with the production end.

Q. Did you discuss with them the formation of a corporation to carry on their production rather than the lack of corporation?

A. As I recall now, I don't think I had anything to do with that, how the corporation was to

(Deposition of Harry M. Warner.)

be formed or what the name was to be. I may have heard it, but I don't think I played any part in that; not that I remember.

Q. Did you discuss with them what percentage of the net profits of the pictures the independent producing venture would receive as opposed to the percentage that Warner Brothers would receive?

A. I laid out the formula that the company, if the two could get together, that—I laid out the formula that [784-229] the company should operate under, and took it up with my brother, and we agreed upon that plan.

Q. And that was basically the formula that was eventually incorporated into the written agreement?

A. No, wait a minute. I merely laid out the plan. I turned it over to Mr. Freston here, as the attorney, and told him to write up a deal—I first explained to him why I wanted it done, and then I told him to write up what was fair to the company, and he did it. I don't think I ever saw it after that. He explained it to me, and when I was sure that he had satisfied himself it was a deal that was fair for all parties concerned, why, that was the end of it, so far as I was concerned.

Q. Did you discuss with them prior to the actual drafting of the contract how the Warner Brothers' overhead would be figured?

A. Yes. I think when it came around to that, I asked our New York people what our overhead was, because I didn't believe that in order to form a company with men of that type and for the pur-

(Deposition of Harry M. Warner.)

pose that you want to use them, you should make money except through their efforts—not on them, but through them—and if I recall, I was told what our overhead was for distribution, and I did that with Mr. Kalmenson. He is our general sales manager. I increased the amount from what it cost. I can't recall as to whether [784-230] they told me it was—it seems to me that they told me at that time it was 14 per cent for distribution in this country.

Mr. Freston: Pardon me for interrupting a minute. I think you are getting away from counsel's question. He asked you about overhead and not about distribution costs.

The Witness: Oh, overhead?

Mr. Freston: Overhead.

The Witness: I consider that overhead; that is overhead, too.

Mr. Freston: He means overhead for use in the facilities of the studio.

The Witness: For the studio, I think I asked Price, Waterhouse to set that up. If I recall right, I think I asked Price, Waterhouse, who are our accountants, to set up what would be a fair deal. That is the way I recall it.

* * * * * [784-231]

Mr. Levy: I offer Exhibits 85-A and 85-B, 85-A being an employment contract between United States Pictures and Charles Yoss; 85-B being an employment contract between United States Pictures and Donald Hyde.

Mr. Williams: To which we object on the grounds

they are incompetent, irrelevant, and immaterial, not tending to prove or disprove the issue now before this court; on the further ground both of them are hearsay. [822]

The Court: What is the purpose of this offer?

Mr. Levy: The purpose of these contracts is to show the course of dealing between Warner and United.

The Court: For that purpose the objection is overruled.

Mr. Williams: Warner was not a party to these contracts. The contracts could not possibly show that.

Mr. Levy: Notwithstanding that, Warner was, by the terms of this contract, affected by the entry into these contracts which are offered in evidence.

The Court: I have ruled in favor of their admissibility.

Mr. Levy: I am sorry, sir.

The Court: Exhibits 85-A and -B are received in evidence. [823]

* * * * *

The Court: Your next offer.

Mr. Levy: Exhibit No. 97-A-1 and A-2.

The Court: Two contracts with John Flynn apparently.

Mr. Levy: Yes, your Honor.

Mr. Williams: These are contracts with actors and actresses.

Mr. Levy: Yes, the contracts with John Flynn I will offer.

The Court: Are they here?

Mr. Schwab: No. I have them, your Honor.

The Court: Is there objection to the offer?

Mr. Williams: Yes, we will object to them upon the grounds they have no tendency to prove this issue involved now before this court and they are irrelevant and immaterial. [842]

* * * * *

The Court: Very well. The objection is overruled. Exhibits 97-A-1 and 97-A-2, the Flynn contracts, will be received in evidence. [843]

* * * * *

The Court: Do you have other witnesses you expect to call on these issues as to jurisdiction and limitations other than Mr. Obringer? Can you give me some estimate of when you will be able to rest on that issue? [848]

* * * * *

The Court: Do you expect to offer that in evidence? Do you wish me to read that this evening?

Mr. Levy: The Bernhard deposition?

The Court: Yes.

Mr. Levy: Mr. Williams made a condition to the offer. In other words, he attached to his stipulation a condition that I will not call Mr. Bernhard, and I asked your Honor——

The Court: On these two issues.

Mr. Williams: On these two issues, yes, your Honor.

Mr. Levy: On these two issues. And I asked your Honor to permit me to defer my decision on that until I shall have had the opportunity to read

again through these Bernhard depositions, until tomorrow.

The Court: Very well. I expect to read Exhibit 122 in evidence, the deposition of Harry M. Warner, to complete that this evening, and if it would save time I would read Exhibits 123-A, B, C and D.

Mr. Levy: Yes, if Mr. Williams had not made the condition, I would be perfectly satisfied to do that.

The Court: Perhaps you could ameliorate the situation [854] by stating whether or not, so far as you are advised, you have any intention of calling Mr. Bernhard on the trial of these two issues.

Mr. Levy: At the present time I have no such thought of calling him.

The Court: On counsel's statement, can you eradicate the condition or remove the condition from the stipulation that Rule 26(d)(2) and (f) will apply to the Bernhard deposition, so the witness Bernhard will be considered an adverse party within the meaning of the rule?

Mr. Williams: Yes, your Honor, I will do that.

I may say that, as a practical matter, I have no doubt that the court will so regard him anyway.

* * * * * [855]

(Plaintiff's Exhibit 123-A, -B, -C and -D for identification was received in evidence.) [856]

* * * * *

The Court: This agreement of October 31, 1945, between United and Warner and the New York Trust Company is in evidence here as exhibit what?

Mr. Levy: That is in evidence here, your Honor,
as Exhibit 8. [860]

* * * * *

DEPOSITION OF JOSEPH BERNHARD

Plaintiff's Exhibit 123-A: Deposition of Joseph Bernhard, a witness in the above-entitled action, taken on behalf of plaintiff Edward S. Birn, at 2:00 p.m. on Thursday, May 8, 1952, at 735 Van Nuys Building, 210 West 7th Street, Los Angeles, California, before Frank Hanna, a Notary Public within and for the County of Los Angeles and State of California, pursuant to notice annexed.

* * * * *

Direct Examination

* * * * * [862]

Q. (By Mr. Levy): Mr. Bernhard, you were a director of Warner Brothers prior to September 10, 1945? A. Yes.

Q. Were you also an employee of Warner Bros. prior to that time? A. Yes.

Q. Were the terms and conditions of your employment reduced into writing?

A. Yes. [862-3]

* * * * *

Q. What was your weekly salary before you quit Warner Bros.?

A. Well, with expenses, it was \$3000 a week.

* * * * * [862-5]

Q. What department in Warner Bros. did you head? A. Theatre.

(Deposition of Joseph Bernhard.)

Q. Just what does that mean? Will you give us a brief description of your duties?

A. Well, general manager of approximately 480 theatres—operating theatres. [862-6]

* * * * *

Q. Mr. Bernhard, in a deposition of Mr. Harry Warner taken on November 8, 1950, Mr. Warner stated that he got you for Mr. Sperling—meaning that he arranged for the association between you and Milton Sperling in U. S. Pictures. Is that so?

Mr. Williams: Just a moment. I object to that as calling for a conclusion and speculation and opinion on the part of the witness, and an improper comment on the testimony of another witness, leading and suggestive; and incompetent, irrelevant and immaterial, for the reasons stated.

Q. (By Mr. Levy): Will you answer the question? A. Repeat it, please?

Mr. Williams: The question also calls for a conclusion as to what Harry Warner meant by certain language he is purported to have used.

Q. (By Mr. Levy): Let me put it this way: Did Mr. Harry Warner approach you to associate yourself in business with his son-in-law, Mr. Sperling? A. Yes. [862-10]

* * * * *

Q. When Harry Warner first approached you on the proposition, just briefly what was the conversation between you? [862-11]

A. That he thought it would be a very good plan for Milton and I to get together. Milton knew one

(Deposition of Joseph Bernhard.)

end of the business and I knew the other, and we could produce some pictures to release through Warner Bros. It appealed to me, because in those days—as it is today—no matter if you got a high salary, you could not retain much of it. So I saw the opportunity of probably building up an estate for myself. Therefore it appealed to me. You see I knew all the exhibitors throughout the country; I knew distribution; and my work in that end would prove very advantageous. [862-12]

* * * * *

Q. It was not at the first conference that you told Mr. Warner that you were satisfied, was it?

A. No. The first few conferences were more or less gossiping conversations.

Q. The proposition was made to you, Mr. Bernhard, and you took time out to consider it? Is that what you mean?

A. I took a great deal of time to consider it.

Q. I assume you called on Mr. Warner again, and talked to him about it?

A. Oh, yes. You see, the visits were far apart; because he was out here and I was in New York.

Q. At that time?

A. Yes. We talked every time we met, whether it was in New York or California. [862-13]

* * * * *

Q. Well, as a matter of fact, your first conversation with Mr. Sperling amounted to practically this: If we get a deal that is satisfactory to the two

(Deposition of Joseph Bernhard.)

of us from Warners, we will become 50-50 partners; is that what you mean?

A. Correct.

Q. That is all there was to that conversation; is that right? A. That is right.

Q. What did you do after that? Did you go to see Mr. Warner?

A. Then we approached Mr. Warner.

Q. Both of you? A. That is right.

Q. And?

A. And we eventually made the deal. [862-17]

Q. I am not talking about eventually. I know you eventually made the deal. But I am trying to get to the negotiations that you had with Mr. Warner, before the deal was outlined finally. Or did you have any negotiations with Mr. Warner?

A. Yes, certainly.

Q. What was the bargaining, if there was any?

A. Well, I don't recall the bargaining. I tried to make a fair deal for both sides.

Q. Did you tell Mr. Warner what you thought a fair deal would be?

A. I suggested a certain deal.

Q. What deal did you suggest?

A. Well, there were modifications eventually made in it, for example, if we were to produce pictures on the lot and I had a discussion on the overhead that they would charge; and we agreed on the overhead, eventually. I thought it was rather high. Now, this is from the United Pictures end. I thought the overhead was very high; because if we

(Deposition of Joseph Bernhard.)

went out and produced our pictures on the outside, I could have benefitted that overhead—or lowered that overhead to—well, probably 20 per cent.

Q. You knew that at the time? A. Yes.

Q. Had you had any experience with the production [862-18] department at all with Warner Bros.?

A. I knew all the bookkeeping phases.

Q. Do you know what Warners' overhead was at that particular time, in 1945, the actual overhead cost?

A. Yes. At that time it was rather high for an independent producer.

Q. Do you know in terms of percentages what the actual overhead of Warners was at the time?

A. Yes; it was over 30 per cent.

Q. Over 30 per cent?

A. Yes. So we finally settled—Do you want to know what we came to——

Q. Yes.

A. We finally settled that Price, Waterhouse would compute the proportion of the pictures to their overhead and we would be charged the proportion that Price, Waterhouse stated would be fair. I think that is even in the contract with Warner Bros.

Q. Yes, it is.

A. (Continuing) And we also discussed the distribution terms; and we finally settled on the terms that are in the agreement.

(Deposition of Joseph Bernhard.)

Q. Do you know what Warners' distribution cost at that time was—actual cost?

A. Yes; I think it was about 16 per cent, actual cost, if my memory serves me right. [862-19]

Q. Who suggested the 20 per cent distribution figure?

A. Well, it was finally compromised on 20 per cent; but that was good terms in those days; because I know——

Q. (Interposing): Good terms for whom?

A. For Warner Bros. Because I know that independent producers were releasing through United Artists for 20 per cent; and I know that Sam Goldwyn at that time was releasing for 17½ per cent. * * * * * [862-20]

Q. Well, specifically, were there any arrangements made between you and Warner with respect to your getting \$78,000 as severance pay, prior to your resignation? A. Yes.

Q. When were those arrangements made?

A. At the time that I resigned.

Q. That was after you had agreed in principle on your association with Mr. Sperling in U.S. Pictures?

A. That is right; because I still had to spend quite a bit of time with the Theatre Department and my successor to—if I may use the term—break him in.

Q. How long did you break him in?

A. Oh, I don't know. I practically commuted back and forth from here to New York; but while

(Deposition of Joseph Bernhard.)

in New York I spent all my time in the theatre department; because there were quite a few things that I, personally, had to attend to, for the theatre department. [862-21]

Q. In consideration of that you got \$78,000; am I to understand that?

A. There was no consideration; it was just severance pay. I thought that, after being with the company for near onto twenty years, I was entitled to the severance pay.

Q. And you made that a condition to your resigning; is that right?

A. Well, I will not say it was a condition, no.

Q. Well, was it an offer made to you by Warner?

A. No. It was a suggestion made by me and acted on by the Board—not Mr. Warner.

Q. When you suggested it to Mr. Warner, what was his response?

A. That we will put it up to the board. Because the board acted on it, I remember that.

* * * * * [862-22]

Q. In negotiating the deal with Mr. Harry Warner, before the contract was drafted, was it understood that you were not to risk any capital and that Mr. Sperling was not to risk any capital, beyond the original investment of \$25,000?

A. No, there was no understanding on that. I was supposed to obtain the first money for each picture — the bank money — not Warners; but I was to.

(Deposition of Joseph Bernhard.)

Q. You were to function, then, in obtaining a loan [862-24] from a bank, to begin the production of these pictures? Is that what you mean?

A. That is right.

Q. Was it then understood that you would not invest any of your own money beyond this \$25,000?

A. There was never any discussion on it, that I can remember.

Q. In other words, it was assumed by both parties that Warners would advance half of the cost of each production, and that you would provide the other half, through banking connections?

A. That is right.

Q. And you did? A. I did.

Q. What was your total investment in this whole deal with United States Pictures?

A. Outside of my time—which, if I had been with Warners, would have been paid for——

Q. I am not talking about your time; but what was the total financial investment that you made?

A. I think it was \$25,000.

Q. You invested \$25,000 cash?

A. No.

Q. What was your total investment?

A. Twelve five. [862-25]

Q. Beyond that you did not invest any money; is that right? A. That is right.

Q. How much did you come out with at the end?

A. Gross, \$400,000. * * * * * [862-26]

Q. I think I understand what you mean. What caused you to sell out, under those conditions?

(Deposition of Joseph Bernhard.)

A. Well, we will say a disagreement on policies.

Q. Can you give us an idea of what that disagreement was based on, or involved, briefly?

A. In policies of what we should do—kind of pictures.

Q. Well, what did you think you should do?

A. I thought we should make less expensive pictures.

Q. When you say less expensive pictures, you mean limiting the budget to approximately how much?

A. Oh, I would say about seven-fifty.

Q. And what was Mr. Sperling's idea?

A. Well, he wanted the higher priced pictures.

Q. By higher price, what do you mean?

A. Higher cost.

Q. Two million dollars or more?

A. No, I don't say that.

Q. A million and a half?

A. Yes. It was just a disagreement on policy.

Q. Was that the only disagreement between you?

A. That is all. * * * * * [862-31]

Q. What part did Mr. Prinzmetal play in this thing?

A. He represented Gary Cooper. Gary has no agent.

Q. Do you know that Mr. Prinzmetal received \$25,000 in connection with the acquisition of Gary Cooper's services? A. That is right.

Q. Can you give us the detail of that deal, briefly?

(Deposition of Joseph Bernhard.)

A. That is all it was. That was the condition.

Q. Tell me exactly what happened.

A. In order to get Gary Cooper, we paid a commission.

Q. You paid Mr. Prinzmetal a commission of \$25,000?

A. That is right. [862-36]

Q. As an agent's commission?

A. As attorney and agent.

Q. Did he ever perform legal services for you?

A. No. * * * * * [862-37]

Q. What part of this \$25,000 was charged to Warner Bros.?

A. It all came under the cost of actors. This is off the record.

(Discussion off the record.)

* * * * * [862-38]

Q. May I assume that, had you passed up the suggestion, shall we say, of Mr. Warner, that you associate yourself with his son-in-law, that it would have had no effect on the renewal of your contract?

A. None whatsoever. I will say that emphatically. None whatsoever. * * * * * [862-41]

Q. Did you personally guarantee any of the U.S. obligations?

A. I don't recall. But morally I was in back of it; because my connection was the New York Trust Company. That was not Warner Bros.' connection. For your information, while we are on the subject of the New York Trust, I originally got the New York Trust many years ago—probably a year after

(Deposition of Joseph Bernhard.)

I was with the company—to loan Warner Bros. some money. That was during the dark days.

Q. You arranged for that loan?

A. I did.

Q. Through Mr. Bierwirth?

A. Through Mr. Bierwirth. I knew Mr. Bierwirth. Not until we got the loan did any of the Warners meet Mr. [862-53] Bierworth.

* * * * * [862-54]

Q. Did you have a residence here in California during that time? A. No.

Q. Did your residence ever change?

A. Never. I always voted in New York; still do.

* * * * * [862-79]

Q. Did you ever have any conversation with Mr. Jack Warner or Mr. Harry Warner prior to your splitting, as you call it, with Mr. Sperling, and in which you informed them, in substance, that you had a disagreement with Mr. Sperling, and that [862-105] you intended to split?

A. It was only to tell them that we intended to split on account of a disagreement in policy.

Q. With whom was that conversation had?

A. With Mr. Harry Warner.

Q. Do you recall what Mr. Harry Warner's response was? A. Sorry to see it happen.

Q. That is all?

A. That is the sum and substance of it.

Q. Mr. Harry Warner did not urge you to remain?

A. Mr. Harry Warner was very sorry, and

(Deposition of Joseph Bernhard.)

would like it if we could clear up the situation—yes, he wanted me to remain.

* * * * * [862-106]

Q. Did Mr. Harry Warner express any opinion as to who was right? A. No.

* * * * * [862-107]

Q. Where were the arrangements made for the sale of the stock? Were they made here in California or in New York?

A. In New York.

Q. In other words, your conversations with respect to the sale of the stock were had with Mr. Sperling in New York?

A. They were had with Mr. Sperling out here, and then back in New York with Stanleigh Friedman.

Q. At Mr. Friedman's office? A. Yes.

* * * * * [862-114]

Q. Is the Mr. Stanleigh Friedman that you refer to a director of Warner Bros.? A. Yes.

* * * * * [862-115]

Q. Did you or did you not resign as a director of Warner Bros. on the strength of having executed this agreement dated August 31, 1945?

A. The date of my resignation is a matter of record. I think that was brought out, was it not?

Q. I will tell you. The date of your resignation is September 10, 1945, ten days subsequent to the signing of this agreement. Now I ask you whether or not it was upon the strength of this agreement that you resigned as a director of Warner Bros.

(Deposition of Joseph Bernhard.)

Mr. Williams: You are speaking now of the agreement on the 31st of August?

Mr. Levy: That is right.

The Witness: Naturally.

Q. (By Mr. Levy): Prior to your resignation from Warner Bros. had you told Mr. Harry Warner or Mr. Jack Warner, or either or both of them, that you had entered into this agreement of August 31, 1945, with Mr. Sperling?

A. It was the reason for my resignation.

* * * * * [862-154]

DEPOSITION OF OLIVER B. SCHWAB

Plaintiff's Exhibit 124: Deposition of Oliver B. Schwab, a witness herein, taken on behalf of the plaintiff, at 10:00 o'clock a.m., Thursday, July 24, 1952, at 141 El Camino Drive, Beverly Hills, California, before Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, pursuant to Notice and Subpoena heretofore served on the attorneys for the defendants and subpoena duces tecum heretofore served on the witness. * * * * * [862-157]

Direct Examination

Q. (By Mr. Levy): What is your full name?

A. Oliver B. Schwab.

Q. You are the Secretary of the United States Pictures? A. That is correct. * * * * * [862-160]

Q. (By Mr. Levy): Did you participate in any

(Deposition of Oliver B. Schwab.)

of the negotiations between Milton Sperling and/or Joseph Bernhard with Harry and Jack Warner before September 28, 1945, which is the date of the first contract entered into between U.S. Pictures and Warner Bros.?

A. I would say that the negotiations of that agreement were carried on by Mr. Bernhard and Mr. Sperling and that I [862-165] was not a negotiator. * * * * *

Q. Well, let me preface the clarification by this question: Did you participate in the drawing of that contract?

A. Only to this extent: As I recall, the contract was drawn by Freston & Files and I looked at it before it was signed. As I recall, I had a discussion or two with Mr. Herbert Freston about it, as a result of which there may have been a few changes made in the contract and that was my relationship to the contract. * * * * * [862-166]

Mr. Levy: Your Honor, Exhibits 93-A and 93-B are minute books of the defendant United States Pictures. They are in two volumes. I do not see the necessity at this time of offering both volumes physically in evidence. I am particularly interested, however, in offering two pages, which are contained in Exhibit 93-A. May I offer those two pages in evidence?

The Court: Do they comprise the minutes of a certain meeting?

Mr. Levy: Yes, sir. * * * * *

Mr. Williams: I will object to it on behalf of

the Warner defendants on the ground there is no proper [884] foundation laid as to them. It is hearsay as to them. And, also, generally, I object to it on the same grounds stated with reference to Exhibit 39.

The Court: Wherein is the foundation lacking?

Mr. Williams: It is not being shown that Warner Bros. had anything to do with what transpired at the meeting or was present at the meeting. I don't raise any objection to foundation as to authenticity of the minutes, your Honor.

The Court: The objection is overruled. You may, if advised, read the excerpt into the record, in lieu of marking the physical exhibit into evidence, if there is no objection.

Mr. Williams: No objection to that.

Mr. Levy: "Minutes of a Special Meeting of the Board of Directors of United States Pictures.

"A special meeting of the Board of Directors of United States Pictures was held at 4000 West Olive Avenue, Burbank, California, on January 2, 1947, at 10:00 o'clock a.m., pursuant to waiver of notice signed by all of the directors of the corporation, which notice was ordered filed with the minutes of the meeting.

"There were present in person Messrs. Milton Sperling, J. C. Yoss, and Oliver B. Schwab, being all [885] of the directors.

"Mr. Sperling acted as chairman of the meeting and Mr. Schwab acted as secretary.

"Mr. Yoss made a motion, which was duly sec-

ended by Mr. Schwab, that the following resolution be passed:

“Resolved: That it is the opinion of this Board of Directors that Mr. Sperling in attending business, semi-business, and social functions in and about the motion picture industry, and in associating with and entertaining at the Hillcrest Country Club and in restaurants and in night clubs and in his home, producers, writers, directors, stars, agents, and other persons in and about the motion picture industry during the past year, and from this time forward, has incurred entertainment and other expenses which are for the benefit of and therefore have been incurred for and on behalf of the corporation;

“That it was the intention of the corporation in paying to Mr. Sperling the sum of \$1000 per week during the year 1946 to have Mr. Sperling bear such ordinary and usual expenses for and on behalf of the corporation out of said sum of \$1000 per week, and that accordingly said \$1000 [886] per week represents compensation in part and in part an allowance for usual and ordinary business expenses incurred by Mr. Sperling for and on behalf of the corporation;

“That said \$1000 per week was not intended, however, to cover any extraordinary or unusual expenses (such as, but not limited to, traveling expenses), and that this corporation shall reimburse Mr. Sperling for any and all unusual and extraordinary expenses heretofore or hereafter incurred by him for and on behalf of the corporation.”

End of resolution.

"The motion was unanimously passed by the affirmative votes of Mr. Yoss and Mr. Schwab, Mr. Sperling refraining from voting.

"Thereupon Mr. Yoss made a motion, which was duly seconded by Mr. Schwab, that the following resolution be passed:

"Resolved: that commencing January 1, 1947, Mr. Sperling's salary from the corporation be raised from \$1000 per week to \$1250 per week;

"And further resolved: that it is in the best interests of this corporation that Mr. Sperling, as President of the Corporation and as producer of its pictures, attend all business, semi-business, [887] and social functions possible in and about the motion picture industry, associate with and entertain at the Hillcrest Country Club, at the Racquet Club, the restaurants and night clubs and at his home, producers, writers, directors, stars, agents and other persons in and about the motion picture industry;

"That the corporation disburse to Mr. Sperling, in addition to his salary as aforesaid, an expense allowance in the amount of \$250 per week to cover all usual and ordinary entertainment and other expenses incurred by Mr. Sperling on behalf of and for the benefit of the corporation;

"And that if at any time hereafter Mr. Sperling incurs any extraordinary or unusual expenses for and/or on behalf of the corporation (such as, but not limited to, traveling expenses), the corporation shall, of course, further reimburse Mr. Sperling for such unusual and extraordinary expenses."

End of resolution.

“The resolutions were unanimously passed by the affirmative votes of Mr. Yoss and Mr. Schwab. Mr. Sperling refrained from voting.

“There being no further business to come before the meeting, on motion duly made, seconded, [888] and carried, the meeting is adjourned.”

Signed: “Oliver Schwab, Secretary.”

* * * * * [889]

The Court: The Yoss deposition, Exhibit 125-A, -B, -C, -D, -E will be incorporated by reference into the reporters’ transcript at this point and may be copied therein if counsel so arrange with the reporter.

(The documents marked Plaintiff’s Exhibits 125-A to -E, inclusive, were received in evidence.) * * * * * [900]

DEPOSITION OF JOSEPH CHARLES YOSS

Plaintiff’s Exhibit No. 125A: Deposition of Joseph Charles Yoss, a witness produced on behalf of the plaintiff herein, taken on Tuesday, August 5, 1952, at 1:30 p.m., at 141 El Camino Drive, Beverly Hills, California, before Edward A. Oreb, a Notary Public within and for the County of Los Angeles and State of California, pursuant to oral stipulation. * * * * * [901]

Direct Examination

Q. (By Mr. Levy): What is your full name, sir? A. Joseph Charles Yoss.

Q. Where do you reside?

(Deposition of Joseph Charles Yoss.)

A. North Hollywood, California.

* * * * * [901-1]

Q. (By Mr. Levy): What is your business, Mr. Yoss?

A. I am treasurer and vice-president of the United States Pictures, Incorporated.

Q. Have you any other business?

A. No.

Q. Are you a Certified Public Accountant?

A. No.

Q. Are you an accountant? A. Yes.

* * * * * [901-2]

Q. What position did Mr. Donald Hyde occupy in the company during the time that he was there?

A. Vice-president.

Q. He was not a director, was he?

A. I don't remember.

Q. What were his duties, generally?

A. An executive assistant to Milton Sperling.

Q. Can you give us an idea of what that means?

A. May we go off the record here for a moment?

Q. Yes.

(Discussion off the record.)

The Witness: He reviewed stories; interviewed talent; criticized plays, material; assisted in the production duties [901-5] assigned to him by Milton Sperling and generally duties of this nature.

Q. (By Mr. Levy): What sort of production duties were assigned to him by Mr. Milton Sperling? A. I don't remember.

(Deposition of Joseph Charles Yoss.)

Q. Is that the best answer you can give me to that question?

A. Other than what I told you just before.

Q. Well, I asked you whether you can—

Mr. Williams: Let us not get into an argument with the witness. He has answered your question. Now, let us not start arguing.

Mr. Levy: Mr. Williams, may I call your attention and the witness' attention to the fact that Mr. Donald Hyde received a salary of a thousand dollars a week.

Mr. Williams: Well, what difference does that make?

Mr. Levy: And it seems to me that it is both relevant and material for the plaintiff to know—for the purposes of this trial—what this man was paid a thousand dollars a week for.

Mr. Schwab: He has already told you that he was executive assistant to Sperling and assisted him in everything Sperling had to do.

Mr. Levy: Well, he didn't say that.

Mr. Schwab: Well, I think it was implicit in his [901-6] answer, when he said he was executive assistant to Milton Sperling.

Mr. Levy: I will adopt Mr. Schwab's suggestion.

Q. Did you assist Mr. Sperling in everything that he was called upon to do?

Mr. Schwab: What do you mean, did he or did Hyde?

Mr. Levy: Did Mr. Hyde?

(Deposition of Joseph Charles Yoss.)

The Witness: If Mr. Sperling requested it, I would say yes.

Q. (By Mr. Levy): Would you call Mr. Donald Hyde an assistant producer? A. No.

Q. I take it, then, that he was less than an assistant producer but more than an ordinary employee when you called him an executive; is that the idea? A. Yes.

Mr. Schwab: You called him what?

Mr. Levy: An executive.

The Witness: I would not answer thusly.

Q. (By Mr. Levy): Well, how would you answer the question?

A. As I have heretofore.

Q. And you can't improve on that?

A. That is right. * * * * * [901-7]

Q. Throughout the extended period provided for by the two amendments that I have just read, and down to the present time, has United States Pictures produced any "original" pictures?

A. Not beyond the first three pictures.

Q. Will you please state the names or titles of all pictures produced to date in the order in which they were made?

A. Cloak and Dagger, Pursued, My Girl Tisa, South of St. Louis, Three Secrets, The Enforcer, Distant Drums and Retreat Hell.

Q. It is a fact, is it not, that the first three [901-10] pictures that you named were produced as "original" pictures and the remaining five were

(Deposition of Joseph Charles Yoss.)

produced as "additional" pictures? A. Yes.

* * * * * [901-11]

Q. (By Mr. Levy): Thank you. It is a fact, is it not, Mr. Yoss, that My Girl Tisa turned out to be a financial loss, a loss in excess of a million dollars?

A. There was a loss on My Girl Tisa in excess of a million dollars. [901-30]

* * * * *

Q. In dollars and cents, Mr. Yoss, approximately how much of Warner Bros.' advances to United States Pictures in the form of cash and/or facilities in connection with the cost of production of My Girl Tisa, including all overhead allocated thereto, still remained unrecouped by Warner Bros.?

* * * * *

The Witness: I believe approximately \$670,000 as of about March 1st.

Q. (By Mr. Levy): Of 1952?

A. Of 1952.

Q. Will you fill in the exact amount in the space immediately below it? A. Yes.

(Information above requested): \$668,108.76.

Q. (By Mr. Levy): In your most recent balance sheet, is My Girl Tisa carried as an asset by United States Pictures? A. Yes.

Q. At what estimated realizable value is it so carried?

A. I don't recall at the moment.

Q. Can you approximate it? [901-32]

(Deposition of Joseph Charles Yoss.)

A. No.

Q. Will you fill in the amount immediately below?
A. Yes.

(Information above requested): No realizable value. [901-33]

* * * * *

Q. Is the figure that you will fill in representing the unrecouped monies advanced by Warner Bros. in connection with Mr. Girl Tisa including all overhead allocated to that picture carried on your books now as a debt to Warner Bros.?

A. It is carried on my books as a contingent liability. [901-34]

* * * * *

Q. (By Mr. Levy): Now, you testified, Mr. Yoss, to the total cost of production of the three "original" pictures, namely, Cloak and Dagger, Pursued and My Girl Tisa; that is to say, you gave us the total of each picture. I have totaled these figures and the grand total is \$5,170,962.35.

Would you like to check that total?

A. No, I will take your word for it. [901-127]

* * * * *

Now, I ask you this question: In the \$5,170,962.35 figure, which you testified as the total cost of the production of the three "original" pictures, was there included the 1946 and 1947 write-offs on literary properties purchased and those written for the company but not used in the production of any

(Deposition of Joseph Charles Yoss.)

picture heretofore produced and charged to U. S. Pictures' overhead?

A. I believe I have answered that in my answers to the interrogatories of a certain date.

Q. Well, can you answer that question yes or no?

Mr. Schwab: Read the question back, will you, please?

(The question was read by the reporter.)

The Witness: Yes.

Q. (By Mr. Levy): And the amount of the 1946 write-off in such connection was \$59,935.63?

A. Yes.

Q. And the amount of the 1947 write-off in such connection was \$43,656.99?

A. In both instances I have confirmed these answers from interrogatories which I have previously given.

Q. Yes. But is that figure correct?

A. Yes, the figure is correct. [901-130]

* * * * *

Q. Now, you use the words "production overhead." Do you distinguish production overhead from any other type of overhead?

A. Yes. [901-194]

Q. Now, what are the distinguishing features, and how do you run your books on those things?

A. I consider items as being production overhead when they indirectly affect in some manner the production of a picture.

Q. Of a picture produced, you mean?

(Deposition of Joseph Charles Yoss.)

A. Not necessarily.

Q. Or a picture produced or not necessarily produced?

A. Both or either, and I don't consider it production overhead when it is corporate expense.

Q. Such as what?

A. Say income taxes.

Q. Yes; what else? A. Interest.

Q. Yes? A. Franchise taxes.

Q. Yes? A. That is enough. [901-195]

* * * * *

Q. So that in general overhead are contained only such items as you specified a moment ago, namely, interest, income taxes and charges by the State of Delaware?

A. We charge to general overhead items those charges which are not proper charges to production overhead.

Q. Well, that is a generalization, Mr. Yoss. It would be better if we broke it down a little bit. Now, you have broken it down somewhat by telling us some of the items that you include in general overhead. Will you finish your job?

A. I gave you three items, and they constitute the bulk of our general overhead. There may be other items in there.

Q. Of what nature?

A. As I told you, anything that doesn't affect the production of a picture.

Q. Can you think of anything?

A. Not at the moment.

(Deposition of Joseph Charles Yoss.)

Q. Not at the moment.

A. Maybe representation service, for example, in Delaware.

Q. Everything else is contained in your accounts of production overhead?

A. I charge to production overhead those things [901-196] which indirectly affect the cost of pictures. [901-197]

* * * * *

Q. Can you tell us how Mr. Bernhard's salary was allocated during the time that he was there; how that was divided, as you call it, or segregated?

A. Half of it was charged to production overhead and the other half was charged to production as a direct cost.

Q. And included in the caption "Producer"?

A. Yes.

Q. In the budget of pictures produced?

A. Yes.

Q. Was any part of Mr. Hyde's salary included as a direct charge to pictures produced?

A. No.

Q. Was any part of Mr. Schwab's fees included?

A. No.

Q. Were they included as a direct charge?

A. No.

Q. Or your salary, Mr. Yoss?

A. No. [901-204]

* * * * *

Q. Well, then, what did you say?

A. Our procedure for writing off stories or any

(Deposition of Joseph Charles Yoss.)

other property is that at the end of any given accounting period, each property is reviewed for the purpose of determining if there is any possibility that this story is no longer of value. Such decision is made by Milton Sperling. If he says that this property is not—there is no opportunity that we will use it as a basis for a picture, then it will be charged into overhead. Now, we may make such a review during the month of January, for example, but its effect, however, would be as of the end of the previous year. [901-237]

* * * * *

Q. Were you in the habit of submitting invoices to Warner Bros. at the end of each week after December 7, 1946? [901-258]

A. It is a regular procedure.

Q. In other words, every week you gave Warner Bros. a list of monies that you had either paid or expended, that is, incurred or expended, during that week; is that right?

A. That is right.

Q. And you would get a check from Warner Bros. the following week, is that right, or right after you sent this request—

A. Generally your statement is correct.

Q. I beg your pardon?

A. Generally your statement is correct.

* * * * * [901-259]

(Deposition of Joseph Charles Yoss.)

Q. Your answer is interesting to me to this extent and I want to interrogate you on the subject: Am I [901-263] to understand that U. S. Pictures would either purchase a literary property or have a literary property written for it and then at some time or another determine for itself whether U. S. Pictures intends to use such property as the basis for an "Original" or an "Additional" picture?

A. We have the right under our contract to designate a picture as an "Original" or an "Additional" as we choose, before we entered principal photography.

Q. Yes, I am aware of that; and it is with respect to that particular portion of your contract that this interrogation is directed. When, between the time that you either purchased or had a story written for you and that way acquired it, and the time you commenced principal photography, when in that interim do you make a decision as to whether a picture is going to be an "Additional" or an "Original" picture?

A. In the past we have made this decision just prior to principal photography commencement.

Q. You mean on the day before?

A. Maybe a few days before; I don't recall.

Q. It may be a few days before. Then what do

(Deposition of Joseph Charles Yoss.)

you do when you decide that this is going to be an "Additional" picture and not an "Original" picture? Just what do you do?

A. I don't understand your question.

Q. Well, in the first place, you have a meeting of [901-264] your Board of Directors, do you, and you make that determination—or does Mr. Sperling make that determination himself?

A. Well, it would be a subject of discussion between us. I don't think there would be a meeting if——

Q. When you say "between us," you mean between whom?

A. Mr. Sperling and Mr. Schwab and myself.

Q. And Mr. Sperling would indicate his views as to whether he wants this an "original" or an "additional" picture; is that right?

A. It would be discussed.

Q. He would make the decision, would he?

A. His would be the final decision.

Q. After he made that decision, what would he do?

A. I would be—I would know of that decision and then I would see that a letter was prepared and Warners notified as to whether it was either "Original" or "Additional."

Q. Have you such letters in your file?

A. Yes.

Q. And in such letters, do you state to Warner Bros. that you intend to commence principal photography on such and such a picture and you design-

(Deposition of Joseph Charles Yoss.)

nite this picture as an "Original" or an "Additional" as the case may be?

A. We indicate to them that we designate the picture either as an "original" or "Additional."

Q. I see. Now, at such time as you make such announcement to Warner Bros., you have assembled, have you not, all of the elements of the picture which you are going to shoot?

A. Generally, yes, or at least we are in the process of it.

Q. Well, you have your director, haven't you, under contract?

A. Presumably so, yes. [901-266]

* * * * *

Q. Do you know of any instance in which a director on any picture that you have produced was chosen only a few days before commencement of principal photography?

A. No, sir.

* * * * *

Q. (By Mr. Levy): Is there any question but that the [901-268] cast of the picture had been assembled at the time that you made such announcements?

A. Well, the principal cast would obviously be assembled. It is generally the practice all during the picture to pick your minor cast as you go along.

Q. But the principals?

A. Yes, the principals would have been chosen.

Q. And your production manager?

A. Yes.

(Deposition of Joseph Charles Yoss.)

Q. Will you not say that as a general proposition, you had all the elements of the picture assembled which you required in order to commence principal photography when you made that announcement to Warner Bros.?

A. As a general proposition, yes.

Q. And by that time you would have gone through the whole process of entering into numerous contracts with personnel involved in the production of that picture?

A. We would have entered into many contracts.

* * * * * [901-269]

Mr. Levy: Yes. I offer in evidence Exhibit 95-H.

Mr. Williams: The same objection, your Honor.

The Court: Overruled. Received in evidence.

(The document was thereupon marked Plaintiff's Exhibit 95-H and received in evidence.)

* * * * *

"United States Pictures, Inc.
Income Tax Return"

This is the heading on the document that I am reading. The further heading: "Loss on Photoplay My Girl Tisa." And this whole exhibit, by the way, if your Honor please, is denominated Amended Return for Calendar Year 1948 of United States Pictures, Inc. [908]

"Under the terms of an agreement with Warner Bros. Pictures, Inc. dated September 28, 1945, and amended November 2, 1945, December 6, 1947, Feb-

ruary 3, 1948, and July 21, 1950, United States Pictures, Inc. has produced at Warner Bros. studio three 'original' motion pictures and three 'additional' pictures to December 31, 1950.

"With respect to the three original pictures, Warner Bros. Pictures, Inc. financed one-half of the cost of each production and the amounts advanced along with various costs and expenses incurred in distribution have been deducted in full or in part by it from the proceeds of each picture. The first two original pictures, *Cloak and Dagger* and *Pursued*, resulted in profits (receipts in excess of all costs and expenses) which in accordance with the terms of the agreement are being shared equally by the two parties.

"With respect to original pictures, subdivision (j) of paragraph Seventh of the agreement provides as follows:

" 'There shall be paid to the Producer (United) the share of the gross receipts hereinbefore provided from each photoplay as same are earned, provided that if any photoplay shall result in a net loss then the amount of said loss shall be recouped by the Company [909] (Warner Bros. Pictures, Inc.) from the proceeds of any or all subsequent photoplay or photoplays, in addition to the other charges and costs which it is authorized to retain from such subsequent photoplay or photoplays until it has recouped such loss. If, within four (4) years after the first general release in the United States of America of the last photoplay produced hereunder the Company has not recouped all of the

moneys owing to it pursuant to the terms thereof, then the Producer shall pay to the Company the amount of such deficiency.'

"The third original picture, *My Girl Tisa* (released in 1948), will result in a loss which the company estimated in its 1948 return would approximate \$1,200,000, calculated as follows:

Cost of Production, one-half of which was financed by Warner Bros. and is repayable on basis set forth below	\$1,645,066.78
---	----------------

Less—Estimated gross receipts re- duced by estimated expenses of distribution	442,746.74
---	------------

Indicated loss	\$1,202,320.04
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In the 1948 return the company deducted amortization of this picture in an amount sufficient to reduce all [910] production costs (financed by both the taxpayer and Warner Bros.) to estimated realizable value and allocated one-half (\$601,660.02) of the estimated loss to Warner Bros. Pictures, Inc. on the assumption that the losses as well as the profits were to be shared equally by the parties to the agreement. However, legal counsel after considering the aforementioned agreement has decided that the taxpayer was not entitled to deduct in its 1948 income tax return any portion of the *Tisa* production costs financed by Warner Bros. Pictures, Inc. because United's liability, if any, to reimburse Warner Bros. for such costs is contingent

and is enforceable only if Warner Bros. has not recouped its loss from the gross receipts of subsequent productions within four years after the general release of the last photoplay to be produced under the agreement.

“In view of the above, amended 1948 and 1949 income tax returns are being filed; these returns and the company’s 1950 return have been prepared to reflect a loss to United of \$403,513.76 on My Girl Tisa, instead of the \$601,660.02 shown in the original 1948 return, computed as follows:”

And on the next page the computation is made.

* * * * *

R. J. OBRINGER

recalled as a witness on behalf of plaintiff, previously sworn, testified further as follows: [916]

* * * * *

Direct Examination—Resumed

Q. (By Mr. Levy): When you were last on the witness stand, Mr. Obringer, I had asked you whether you knew the meaning of the words “general purposes,” which words are contained in the answer to Interrogatory H in Exhibit 107 in evidence, [917] on page 2 of that exhibit. [918]

* * * * *

Q. (By Mr. Levy): Mr. Obringer, did you yourself frame the answer, namely, H, that we are referring to? A. No, sir.

Q. Am I to understand, then, that somebody else authored the answer?

A. That is correct.

Q. Do you know who its author was?

(Testimony of R. J. Obringer.)

A. No, I do not. The interrogatories were presented to me for my signature as an officer of Warner Bros. Pictures, Inc., and the information which I verified was served by various departments in New York and the local studio.

Q. I take it, this was the situation: there was presented to you Exhibit 107 and you thereupon formally [919] affixed your signature thereto as an officer of Warner Bros.?

A. That is true.

* * * * *

Q. Mr. Obringer, did you have any information with respect to the dates of release of any of these pictures? And when I use the word "release," I refer to general release in the United States.

A. No, sir, none whatsoever. [920]

Q. You never had that information?

A. That information is a New York detail.

Q. So that, if you made answer in these interrogatories with respect to release dates, that also falls in the category of information that has been supplied to you and which you formally verified; is that correct? A. That is correct.

Q. You have, then, no independent knowledge of the dates of release of any of these pictures?

A. None whatsoever. [921]

* * * * *

Q. (By Mr. Levy): Mr. Obringer, I direct your attention specifically to paragraph 5 which I will read to you.

* * * * *

(Testimony of R. J. Obringer.)

The Court: You are referring to Exhibit 4, is it?

Mr. Levy: Exhibit No. 4 in evidence. [929]

* * * * *

Mr. Levy: Well, let me read it again. This is a very poor photostat.

“Paragraph 5. You agree that prior to commencement of principal photography of any of the photoplays hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay as hereinbefore referred to.”

Q. Were you the author of that particular paragraph?

A. I would say that that paragraph was worked out either between myself and Mr. Schwab or Mr. Voss purely from a practical standpoint.

Q. Pardon me?

A. Merely from a practical standpoint, if we were going to do an original picture it involved a different type of financing than it would be if it would be an additional [930] picture, and we had to know what we had to do in advance.

Q. That is the explanation for the inclusion of paragraph 5?

A. That is the purpose of the paragraph; yes, sir.

Q. Was that the sole purpose of it?

A. As far as I know, yes.

* * * * *

Q. May I ask you this, Mr. Obringer: At the

(Testimony of R. J. Obringer.)

time that this paragraph was drawn were you familiar with the fact that preproduction of a photoplay might involve the expenditure by Warners or the advance by Warners of large sums of money? When I say "large" I mean sums ranging from \$50,000 to a quarter of a million dollars.

A. With respect to the production of photoplays in general?

Q. Preproduction? A. Preproduction?

Q. Yes.

A. Yes, I am familiar with that fact and provided for it by the contracts. [931]

* * * * *

Q. (By Mr. Levy): Do you know, Mr. Obringer, that in the course of the preparation for production of a photoplay, whether by Warner Bros. Pictures or by an independent producer, a script has to be written? A. Yes.

Q. Do you know that?

A. Certainly, I do.

Q. Do you know that the thing starts with a story, whether it be a book, short story, novel or stage play—you know that?

A. I am familiar with that phase.

Q. Do you know that occasionally the purchase of such story, stage play, or magazine short story runs into considerable [932] money?

Mr. Williams: Just a moment. If your Honor please, I object to this question on the ground that it has no relevancy to the issues involved in this case what this witness knows of the subject.

(Testimony of R. J. Obringer.)

The Court: Overruled. He may answer.

Q. (By Mr. Levy): Do you know those things?

A. I have reasonable knowledge that those things take place, yes.

* * * * *

Q. (By Mr. Levy): Were you aware—put it that way—of the fact that under paragraph 5, United States Pictures had the right to withhold advising Warner Bros. Pictures of whether or not a picture which United States Pictures [933] had been preparing for production, namely, for photography, would be an original or an additional picture up to the very moment that United States Pictures through its directors would step on the sound stages and begin turning the camera; were you aware of that fact?

Mr. Williams: That is objected to as argumentative as to form, and the document speaks for itself.

The Court: Sustained.

Mr. Williams: As to what the rights are.

The Court: You may inquire as to his understanding if you are so advised.

Q. (By Mr. Levy): Did you understand, Mr. Obringer, at the time that this particular paragraph was authored by you that the situation was as I described it in the previous question?

Mr. Williams: That is objected to, if your Honor please, as improper in that it is the question as to which your Honor has already sustained an objection.

(Testimony of R. J. Obringer.)

The Court: Overruled. If the witness understands it. Do you understand the question?

The Witness: No, I do not. Will you repeat it, please?

The Court: I suggest you rephrase it.

Q. (By Mr. Levy): At the time that paragraph 5 was incorporated by you in Exhibit 4 in evidence was it your understanding that United States Pictures had the right to [934] prepare a motion picture, proceeding from its initial stages, namely, the purchase or other acquisition of the material upon which the picture was based, the processing of it through having it written and developed into a scenario, a shooting script, assembling of a cast therefor, the employment of the personnel, directors, stars, etc.—that United States Pictures would have the right—was it your understanding that United States Pictures would have the right to do all of that which I have just described, and incur the expense embraced in such behavior, and not notify Warner Bros. Pictures as to whether the product of all that I have indicated to you would be used by United States Pictures in the production of an original picture or an additional picture? A. Well——

Mr. Williams: If your Honor please, that is a question which is absolutely argumentative in every sense of the word.

The Court: Overruled.

Mr. Williams: It involves an entire series of matters which are not involved in this question at

(Testimony of R. J. Obringer.)

all, and involves a completely different series of clauses in the contracts involved.

The Court: Overruled. You may answer.

A. Well, the details which you have enumerated did not enter my mind as regards the preparation of this paragraph [935] 5. It was purely designed to put us on notice as to whether or not we were to finance 100 per cent or to provide for 50 per cent of the finances. That was the sum and substance of the paragraph.

Q. (By Mr. Levy): I see. And that is the explanation that you have for it? A. That is.

Q. Were you aware of the fact that Warner Bros., in the case of the picture being an additional picture, would have financed all that I have just described to you in the previous question 100 per cent, whereas if the picture were at the last moment denominated by United States Pictures as an original picture, Warner Bros. would be financing only 50 per cent of such costs? Were you aware of that?

A. Yes, I was aware of it, but, to me, it would be immaterial until we came to the point when we commenced financing whether it shall be 50 per cent or 100 per cent.

Q. It was immaterial? A. True. [936]

* * * * *

Q. Mr. Obringer, at the time you authored Exhibit No. 4 and particularly paragraph 6 of Exhibit No. 4 were you aware of the fact that United had

(Testimony of R. J. Obringer.)

charged as overhead to the picture Cloak and Dagger the sum of \$116,801.94?

A. No, sir. That information would be an accounting problem and I wouldn't have any knowledge of it.

Q. So that at the time that this document was drawn by you, you had no idea of how much United had theretofore apportioned to its overhead, is that right?

A. That is right. I had no knowledge and it was not within my province. [958]

* * * * *

Q. I take it, then—and correct me if I am in error—that at the time Exhibit 7 was executed and prior [961] to the time it was executed you, as an individual, had no knowledge of how much United had theretofore allocated to all of the pictures that it had produced up to that time, in the form of overhead?

A. It was strictly an accounting problem. I had no knowledge whatsoever.

Q. Now, Mr. Obringer, will you take Exhibit No. 107 that is before you and turn to the very last page in that exhibit. It is referred to as "Schedule H." That is, is it not, a further amendment to the basic contract, namely, Exhibit 1?

A. That is correct. [962]

Q. Were you the author of that document?

A. I was.

Q. Namely, Schedule H? A. Correct.

Q. Might I ask you whether at the time you

(Testimony of R. J. Obring.)

offered Exhibit 7, being the July 21, 1951, amendment to the master contract, whether you knew that My Girl Tisa had sustained a loss of approximately a million dollars?

Mr. Williams: If your Honor please, that is objected to as assuming facts not in evidence, to wit, that it had sustained such a loss.

Mr. Levy: The evidence, by the admission of the parties, indicates that My Girl Tisa had sustained a loss of a million and two hundred-odd thousand dollars.

Mr. Williams: There is not any question of a loss on My Girl Tisa at that time or at any time. There was a failure up to that time to have recouped the amount of money that was put into the picture.

The Court: Was there a failure of recoupment at that time?

Mr. Williams: There was a failure of recoupment at that time.

The Court: To the extent of a million dollars?

Mr. Williams: I don't think that much at that time. I think it was around eight hundred thousand dollars at [963] that time.

Mr. Levy: Let me reframe the question, then.

Q. At the time you offered Exhibit 7, were you aware of the fact that there had been a failure to recoup approximately \$800,000 on the part of Warner Bros. as the result of the production of that picture?

A. I have no knowledge whatsoever of the prof-

(Testimony of R. J. Obringer.)

its or losses on pictures. I received no such information.

Q. And your answer applies equally, I take it, to Schedule H that is contained on the last page of Exhibit 107? A. It does.

Q. You had no knowledge at that time whether there had been a failure to recoup on the part of Warner Bros. any amount of money?

A. None whatsoever.

Q. And you similarly had no knowledge of how much United States Pictures had allocated to the production cost of any picture and all pictures that it had produced prior to August 12, 1952?

A. I don't understand your question.

Q. Let me reframe it, then. On August 12, 1952, or immediately prior to that time, when you authored the document which is indicated as Schedule H in Exhibit 107, at that time or at those times you had no knowledge of how much United States [964] Pictures had allocated as United's overhead to the production cost of all pictures theretofore produced, or any picture theretofore produced, by United up to that time?

The Witness: Your prior question did not inform me that the allocation pertained to overhead, but my answer is I absolutely had no knowledge.

Mr. Levy: That is all.

Cross Examination

Q. (By Mr. Williams): Mr. Obringer, just a couple of questions with respect to Exhibit 7. I

(Testimony of R. J. Obringer.)

understand that you received your instructions to draw that document from Mr. Sam Schneider.

A. That is correct.

Q. And, after that document had been prepared, you stated the substance of it to Mr. Jack Warner, who approved it?

A. Who approved my signing it as an officer of the corporation.

Q. Did you prepare the document without assistance from anybody else?

A. Yes, I did. Having the facts from Mr. Schneider, this was more or less of a duplication of the previous amendment. [965]

The Court: Does the record show who Mr. Schneider is?

Mr. Williams: Mr. Sam Schneider, a vice president and director of Warner Bros.

Q. That is the Sam Schneider you are referring to? A. Yes.

Q. Who at that time happened to be on the Coast? A. He was in the Coast Studio.

Q. The point I was trying to make was that there was not any negotiation between you and any attorney or other person representing United States Pictures as to the phraseology of that Exhibit 7?

A. No; except to this extent: that Mr. Schneider gave me the details, which were outlined to Mr. Warner, who issued approval for the draft of the document; it was prepared and I recall submitting it to Mr. Schwab, attorney for United, for his acceptance or rejection, and it was accepted.

(Testimony of R. J. Obringer.)

Consequently, the document was executed; copies were disbursed, copies sent on to the trust department in New York.

Q. In Schedule II attached to Exhibit 107, that is the contract of August 12, 1952, from whom did you get your instructions as to writing that contract?

A. I received a telephone call from Mr. Herbert Freston of the law firm of Freston & Files, Warner Bros. [966] West Coast retainers, to the effect that he had had a conversation with an officer of United regarding the preparation of the document to call for two additional pictures, and stated inasmuch as I had theretofore prepared amendments of similar character, he suggested I prepare it, which I did, and submitted it to Mr. Schwab.

Q. Was it accepted without modification, Mr. Obringer?

A. Well, there was some discussion between Mr. Schwab and me on form. I had prepared a draft which paralleled the July 21 agreement by referring to various subdivisions, and Mr. Schwab indicated that perhaps it was a little too verbose in language, and to just reduce the fact to the substance of it, that I had submitted two pictures and extended the term three years.

I thereupon saw no objection to it, and revamped the amendment and sent it over for acceptance by him, which he did, and it was subsequently concluded. * * * * * [967]

(Testimony of R. J. Obringer.)

Redirect Examination

Q. (By Mr. Levy): I don't quite remember whether I asked you whether you got Mr. Jack Warner's O.K. on the August 12 Schedule H of Exhibit 107. A. I did, sir. * * * * *

Q. And he said, in effect, "O.K., go right ahead"?

A. "It is approved to execute."

* * * * * [969]

Mr. Levy: May I, until he returns, your Honor, read a portion of the Statement of J. S. Yoss, who is the accountant for the United States Pictures, into the record.

The Court: A statement or a deposition?

Mr. Levy: It is his statement under oath, and this document was subscribed, sworn to and served upon me pursuant to an agreement had between Mr. Schwab and myself following a motion that had been made before your Honor and came on duly to be heard for an order directing Mr. Yoss to answer questions that he had refused to make answers to during the course of his deposition, and, as a substitute for making answers in accordance to the questions that were propounded to him, he made this statement which we accepted in lieu of his making an answer to each such question.

The Court: It should be offered in evidence, should it not?

Mr. Levy: The reason why I am not offering the whole statement in evidence is because it treats with other matters [980] separate and apart from

the questions that he was asked which were involved in the motion which was brought on before your Honor.

The Court: Let it be marked for identification.

* * * * *

The Court: The Yoss statement just referred to will be marked Plaintiff's Exhibit 126 for identification. * * * * *

Mr. Williams: If your Honor please, knowing the contents of that statement, which your Honor of course does not know at this time, I wanted to interpose an objection on the ground it is not relevant to the issues now being tried before this court. The statement has to do, if I remember correctly, principally with the two matters: One is the matter of the sale by Mr. Bernhard of his stock to Mr. Sperling, and the other is the matter of the creation of the trust in favor of the children of Mr. and Mrs. Sperling. We cannot concede that that has any relevancy to the issue now before this court. For that reason we object to it on that ground.

The Court: Overruled. [981]

Mr. Levy: Paragraph 10 in Exhibit 126 for identification reads as follows:

"10. Statement of facts concerning loan by Milton Sperling of \$400,000 from the New York Trust Company: The \$40,000 sum referred to on page 50 et seq of the August 13, 1952 session of the J. C. Yoss deposition was borrowed by Milton Sperling from the New York Trust Company on September

16, 1946. Milton Sperling executed a promissory note for said sum dated September 16, 1946. Betty Sperling deposited certain stock, owned by her, of Warner Bros. Pictures with the New York Trust Co. as security for repayment of the loan. Milton Sperling has paid all interest due on said loan since that date. Milton Sperling paid \$100,000 on account of the principal of said loan on or about December 27, 1946, reducing the unpaid balance to \$300,000, which is the present unpaid principal amount of the loan;

11. Statement of facts concerning Title Insurance and Trust Co. trusts: On or about December 23, 1946, Milton Sperling and Betty Sperling, as Trustors, established two trusts with the Title Insurance and Trust Company as Trustee. One of these trusts had as its primary beneficiary Susan Sperling, daughter of Milton and Betty Sperling, and the other trust had as [982] its primary beneficiary Karen Sperling, daughter of Milton and Betty Sperling. The Trustors made gifts to each of said trusts of \$52,700 and 15 shares of United States Pictures stock. Thereafter, and also on December 23, 1946, the Title Insurance and Trust Company, as trustee of each of said trusts, purchased from Milton Sperling 16 shares of stock of United States Pictures, Inc., for each trust, for the sum of \$51,200 for said 16 shares. Each of said trusts accordingly now owns 31 shares of stock of United States Pictures, Inc."

This statement was signed by J. C. Yoss, sub-

scribed and sworn to before Oliver B. Schwab, Notary Public in and for the County of Los Angeles, or in and for said county and State of California, Mr. Schwab?

Mr. Schwab: Oh, yes. * * * * * [983]

Mr. Levy: I do not recall, your Honor, whether the deposition of Mr. Yoss stated this fact clearly or not, but if it does not, I believe we could save time, instead of putting the witness on the stand in order to bring this back into the record. It is:

That on the 3rd day of March, 1947 United States Pictures borrowed the sum of \$150,000 from The New York Trust Company. The collateral for that loan was not any of the pictures that are involved in this litigation. The collateral for said loan was the personal guarantee by Harry M. Warner of that note.

If we can have that fact stipulated in the record, I think we can save time, the fact being, namely, on March 3, 1947 United States Pictures borrowed \$150,000 from The New York Trust Company. On that day it made, executed and delivered to The New York Trust Company its note in the sum of \$150,000; that that note was endorsed by Harry M. Warner. [984]

Mr. Williams: We stipulate that those are the facts, but we object to the facts on the ground they do not tend to prove the issue now being tried before this court or any part thereof.

The Court: Overruled. The facts as stipulated are received in evidence.

Mr. Levy: May we have a stipulation as to this further fact, namely, that the note in question was a demand note; further, that United States Pictures has to date paid on account of said note the sum of \$45,000 and that there remains due, owing and unpaid by United States Pictures to The New York Trust Company on said note the sum of \$105,000?

Mr. Williams: We will stipulate that, subject to the objection which we have made, with the further statement that they have paid in addition to the \$45,000 interest on account of that said loan.

Mr. Levy: Very well, sir.

The Court: You make the same objection to the facts so stipulated?

Mr. Williams: The same objection, yes.

The Court: As made to the previous stipulation?

Mr. Williams: Yes, your Honor.

The Court: Objection overruled. The facts as stipulated are received in evidence.

* * * * * [985]

The Court: Exhibit C for identification is received in evidence.

(Defendants' Exhibit C for identification was thereupon received in evidence.)

* * * * * [992]

Mr. Williams: I will call Mr. Herbert Freston.

HERBERT FRESTON

called as a witness on behalf of defendants, having been duly sworn, testified as follows:

The Clerk: State your name to the court.

The Witness: Herbert Freston.

The Clerk: Will you state your address?

The Witness: 650 South Spring Street, L.A. 14.

Direct Examination

Q. (By Mr. Williams): What is your occupation, Mr. Freston?

A. I am an attorney at law.

Q. How long have you been admitted to practice?

A. This coming July will be 40 years.

Q. You have been practicing during that entire time in what locality?

A. In Los Angeles, with the exception of about two years in the Army Air Force in World War I.

Q. Are you at the present time connected with any law firm? [993]

A. The law firm of Freston & Files.

Q. And you are the Freston of Freston & Files?

A. Correct.

Q. In connection with your work as a lawyer, have you occupied any official positions at the bar?

A. President of the Los Angeles Bar Association, 1940 to 1941; a member of the Board of Governors of the State Bar of California, term expiring in 1947; and Vice President of the State Bar of California.

Q. During the course of your practice have you

(Testimony of Herbert Freston.)

had anything to do with the matter of representing persons or corporations in the motion picture industry? A. I have.

Q. Beginning at what time?

A. My first contact with the motion picture business, I think, was in 1916, at which time I was in the office of counsel representing Paramount Pictures in this location, or in this locality.

Q. At that time did you perform services in connection with problems arising out of the motion picture industry?

A. I began to at that time, yes, sir.

Q. Have you ever since that time had connection as an attorney with the motion picture industry? A. Since about 1923, quite actively, yes.

Q. In 1923 what did you undertake in the way of professional work in the motion picture industry?

A. In that year our firm became counsel, West Coast counsel, for Warner Bros. Pictures, Inc.

Q. Has your firm been counsel for that corporation ever since? A. It has.

Q. Has that work been an active representation of that corporation?

A. Very active.

Q. In the course of that business, have you personally attended to many of the affairs of Warner Bros. Pictures in a legal way? A. I have.

Q. During that time have you had anything to do with the drawing of the so-called production-distribution contracts?

(Testimony of Herbert Preston.)

A. Yes, I have drawn several, and participated by way of conferences and assistance in the drawing of a number of others.

Q. About what was the date of the first such contract you ever drew?

A. The first one was between Warner Bros. and Cosmopolitan Productions, which was, I think, in 1934 or 1936.

Q. That was the one involving the services of [995] Marion Davies? A. Correct.

Q. Then, at a later time, did you or your firm have something to do with the drawing of this contract which has just been marked in evidence as Defendants' Exhibit A-17-1 to -5, inclusive, that is, the Frank Capra 1940 contract?

A. Yes. Our office drew that contract. The actual dictation, I think was done by Mr. Lewis, but we all conferred with respect to the preparation of it.

Q. Are those the two contracts that you now remember that you personally participated in prior to the matter involved in this case?

A. That's correct.

Q. You have spoken of your firm as being attorneys for Warner Bros. Pictures, Inc. since 1923. Do you in that capacity represent the firm at all places or just on the Pacific Coast, the West Coast?

A. The West Coast.

Q. Does the firm have counsel in New York, who operate at the New York offices and represent them in matters that arise in New York?

(Testimony of Herbert Freston.)

A. Yes; the general counsel's office is in New York City, with whom we are in contact continuously.

Q. In other words, as problems arise, you and they [996] confer with each other concerning those problems? A. That is correct.

Q. Who is the general counsel of Warner Bros. Pictures? A. Mr. Robert W. Perkins.

* * * * *

Q. Is Mr. Stanleigh P. Friedman also an attorney for Warner Bros. Pictures, Inc. in New York?

A. Yes, he is.

Q. And Mr. Joseph P. Karp, who is gracing this courtroom with his presence? A. Yes.

Q. He is one of those attorneys, and has been for a number of years?

A. Many years. * * * * * [997]

Q. Mr. Roy J. Obringer was with us here. Is he connected with your firm? A. He is not.

Q. What is his capacity with Warner Bros. Pictures, Inc.?

A. He is what we refer to as lot counsel, or resident counsel, at the studio of Warner Bros. Pictures, Inc., in Burbank. * * * * *

Q. (By Mr. Williams): Speaking generally, what is the character of matters handled by Mr. Obringer and those handled by your firm?

A. Mr. Obringer is in charge of what we refer to as [998] the contract department at the Studio. He draws contracts of various kinds with talent whose services are used in the pictures. He takes

(Testimony of Herbert Freston.)

care of the exercise of options under contracts, and takes care of notices where notices are called for under contracts. He drafts amendments to those contracts and also sits in as a studio executive with Mr. Jack Warner and others on the lot in the negotiation of contracts. * * * * * [999]

Q. I will ask you whether sometime in August of 1945 you had a conversation with Harry M. Warner in respect of a proposed contract between Warner Bros. Pictures, Inc. and United States Pictures? A. I did.

Q. When and where did that conversation take place?

A. I believe the conversation took place at Mr. Warner's ranch home in the Calabasas area on a Sunday afternoon immediately preceding the drafting of that contract.

Q. Can you fix the date of that conversation?

A. I believe that was on Sunday, August 19, 1945.

Q. What was the substance of what was said by Mr. [1000] Warner to you at that time and what did you say to him on this subject?

A. Mr. Warner told me in substance that he was not a production man; that he was the over-all supervisor of operations of Warner Bros. Pictures, Inc.; that he was very much concerned concerning the health of his brother Jack, who was in charge of production at Warner Bros. Studio.

He told me, as he put it, that Jack had been hauled out of the studio in an ambulance, and that

(Testimony of Herbert Freston.)

the family doctor, Dr. Hirschfeld, had come to Mr. Warner and told him that his brother might be seriously ill, and that since Jack was in charge of production, that he, H. M. Warner, should do something about getting the studio ready to carry on in the event anything happened to Jack.

He also told me at that time that Joe Bernhard, who had been with the Warner organization a number of years, was leaving that company for the purpose of going into independent motion picture production.

He told me that Joe Bernhard had already organized a corporation to engage in that production, and that it was the plan to have Joe Bernhard join with Milton Sperling to form an independent producing unit to produce motion pictures on the Warner lot for distribution through the Warner distributing agency. [1001]

Mr. Warner told me that Sperling, whom I had known since 1932 myself, had had considerable production experience and that he, Warner, had a great deal of confidence in both the ability and integrity of Sperling and he thought it would be an ideal combination to set up such a concern to produce pictures on Warner lot for the purpose of supplying Warner with pictures vitally needed for exhibition in the theatres and for distribution, and, at the same time, as a result of the additional experience which Sperling would attach in that production program, enable him to evolve into a producer of great ability and understanding, to the

(Testimony of Herbert Preston.)

end that if anything should happen to J. L. Warner, Sperling would be able to render his assistance in keeping the Warner production program going.

Warner told me that he had confidence in Sperling, in his honesty and his ability, and that had he been obliged to turn elsewhere now to get some other producer in whom he had confidence, he would not know where to turn.

So he said this corporation would enter into a contract with Warner Bros. Pictures to produce on the Warner lot for Warner distribution——

Mr. Levy: May I interrupt for a moment. By "this corporation" may the witness indicate what he means?

A. It is the corporation, Mr. Levy, that subsequently became known as the United States Pictures, Inc., the [1002] original name being known as the Comet Productions, Inc. which Mr. Bernhard had incorporated himself through his own counsel in New York City, Simpson, Thatcher and Bartlett, I think, did the work.

Now, at that point Mr. Warner asked me to draw that contract. He said, "I would appreciate it if you would take personal charge of it."

At that point I asked him some questions. I said, "First of all, you realize that Sperling is your son-in-law."

He said, "Of course I do. What I want here is simply a contract that is fair both to Warner Bros. and the independent producer. For that reason I have asked you to draw that contract and I am con-

(Testimony of Herbert Freston.)

fident that you will make it a fair and workable arrangement." I said to him—asked him some of the highlights of what the deal was to be. I said, "What is the distribution charge going to be"?

"Well," he said, "that has not been definitely decided yet but I have contacted the New York office and I am told that we could distribute that picture for around 14 or 15 per cent."

I also asked him—— [1003]

* * * * *

A. ———what the overhead charge would be on the furnishing of facilities by Warner Bros. to this independent production corporation.

He told me at that the United States Pictures would not use all of the services normally rendered by Warners to an independent producer, since it would be an independent producing unit on its own account, and therefore he was having Price, Waterhouse & Co., certified public accountants, determine on the basis of executions just what the proper overhead would be under this contract—a rate that would be fair to both Warner Bros. and to the producer. He told me also that Price, Waterhouse would put that in letter form and that would simply be a part of the contract.

Q. Was anything said as to the number of pictures proposed to be produced?

A. Yes, I asked him that. He told me that the plan then agreed upon tentatively was to produce six pictures over a period of three years.

(Testimony of Herbert Freston.)

Q. Was anything said as to how the pictures would be financed?

A. At the outset nothing was said about how the [1005] pictures would be financed, except to say that Warner Bros. would furnish a half of the production costs and United States Pictures the other half of the production cost.

Q. What further was said in that conversation?

A. He said that he had had a number of conferences with Mr. Bernhard and that he and Mr. Bernhard had agreed tentatively upon the highlights, some of the principal provisions of this contract. I asked him generally what they were and he said, "Bernhard and I have talked it over. If you will see Bernhard, he will give you the highlights of our agreement."

Q. Was that the substance of that conversation?

A. I think it was. It was a long conversation, Mr. Williams. Many things were said, and I think that is the highlights of it.

Q. That, as you have stated, was on the 19th of—— A. August, 1945.

Q. ——August, 1945. What then did you do with reference to this proposed contract?

A. I went down to the office on the next morning, which was Monday morning, and when I arrived there I found that Mr. Obringer had been to the office on the preceding Friday when I was in San Francisco and had left at the office a draft of a contract which he had prepared, a production-

(Testimony of Herbert Freston.)

distribution contract between Warner Bros. Pictures and Michael Curtiz Productions. That, however, was not a formalized or executed contract, simply a draft that was retained in the process of working out an agreement between Warner Bros. and Michael Curtiz Productions.

That contract I examined very carefully. Also at the time I had before me the Frank Capra Productions contract offered in evidence as Exhibit——

Mr. Williams: That is the one that has been marked A-17-1-5, inclusive. [1007]

* * * * *

Mr. Williams: I think you had stated that you had examined it?

A. I did examine that contract very carefully. I also examined carefully at that time the Frank Capra Productions contract in evidence here as No. A-17, Exhibit A-17. The Frank Capra—or, rather, the Michael Curtiz Productions draft that I have referred to appeared to me to be a very suitable form and a form that I was eminently satisfied with so far as its general provisions were concerned. And therefore, in view of the great rush in turning out the first draft of what is now Exhibit No. 1, since it was turned out in just one day, I had recourse to a number of general provisions incorporated in the Michael Curtiz contract which I concluded were most satisfactory to Warner Bros. under this contract. [1008]

Q. Did you have anything else before you when you started to draft this contract?

(Testimony of Herbert Preston.)

A. Yes, I did. I also had before me the summary of the highlights agreed upon, so Mr. Warner said, between him and Mr. Bernhard.

Q. And from what source did you get that?

A. I don't remember where I got that. My impression is that it was handed to me by Mr. Bernhard. It might have been at my office on Monday morning with the other papers Mr. Obringer left. That I cannot recall, Mr. Williams.

Mr. Levy: May I inquire at this time if the witness is referring to a document when he says "a summary"?

The Witness: I am referring to a document, Mr. Levy, which I will be very happy to present.

Q. (By Mr. Williams): Will you state what length of time you took in drafting or making the first draft of this contract which ultimately became the Exhibit No. 1?

A. The first draft of this contract was finished about a quarter of 11:00 p.m. on the night of Monday, August 20, 1945.

Q. And after having completed that first draft what, if anything, did you do with it?

A. I went out to the studio, I believe the next day, and had a conference, I believe with Mr. Obringer, one or both of the Warners, and I do not recall whether Mr. Schwab [1009] was there or not.

Q. Following that did you then make some amendments or changes in the first draft?

A. Yes, I made a number of amendments and

(Testimony of Herbert Freston.)

changes in the first draft, and that first draft as the result of those changes and revisions became the second draft.

Q. At the time that you discussed the first draft with Mr. Bernhard and one or more of the Warners and whoever else was there do you remember what the substance of that discussion was?

A. Well, there were a number of changes made in it. I don't recall just what they were at the moment. However, in preparing that first draft, in view of the uncertainty as to what the distribution charge was, I left the distribution charge blank in that contract. As a result of the conference regarding that first draft, somebody at that conference wrote in the figure of "15"—"15 per cent distribution charge" in the blank space which I had left in that contract.

I came back to the office following that and, as I say, worked on the second draft and I think I finished that late the following night.

Q. What did you do with the second draft?

A. The second draft, I believe I left a copy of it at the Beverly Hills Hotel for Mr. Bernhard so that he [1010] and his counsel, Mr. Schwab, could examine it.

Q. And what did you do following that?

A. Well, following that I had an extended conference with Mr. Schwab in my office a few days after that. The conference was held in our office between Mr. Schwab and me on August 27, 1945. Mr. Schwab wanted a number of changes in that

(Testimony of Herbert Preston.)

contract, some new paragraphs, some additions. We discussed that perhaps an hour or two.

As a result of that negotiation between Mr. Schwab, representing U. S. Pictures, and me on behalf of Warner Bros. Pictures, we agreed on a number of changes in that contract. Some I did not agree to. It was an arm's length negotiation.

* * * * *

A. Mr. Schwab was in my office, representing the United States Pictures, and I at the time was representing the Warner Bros. Pictures. I went over the suggestions that he had in mind, which changes and additions, some of which [1011] we argued over for some time, some of which I gave in on, some of which I did not, and it was also agreed at that time with respect to certain clauses that Mr. Schwab wanted, that I agreed to if he himself would draft those suggested clauses and submit them to me in letter form. He did that.

Q. (By Mr. Williams): Are you able to remember at this time, without referring to any notes or memoranda, what the particular points were that were discussed between you and Mr. Schwab?

A. I could not remember all of them without referring to Mr. Schwab's letter and to my notes, but one of them related to the budget. In my first draft I had provided that the budget for the picture was subject to the approval of Warner Bros. Pictures, Inc. Mr. Schwab requested that that clause be so changed as to provide for a budget

(Testimony of Herbert Freston.)

of \$850,000 not subject to approval but subject to Warner's approval if the budget exceeded that sum.

Also Mr. Schwab and I in our discussion, in arguing over the budget provision, considered the matter of Warner Bros. unreasonably withholding its approval of any budget; and also we argued with respect to the right of Warner Bros. to question any single item a part of the budget. He asked that the clause be so changed that Warner should not have the right to object to any single item in the budget, and inasmuch as my clause provided that Warner should have the [1012] right of approval if the budget exceeded \$850,000, that seemed perfectly satisfactory to me and I said, "Okay," and I prepared that accordingly.

* * * * *

Q. What was your opinion at that time of the effect of Warner Bros. having the right to approve or disapprove the budget as a whole?

A. I thought that was amply sufficient for Warner Bros.' purposes and would afford full protection to my client, knowing, as I did, that it was a rare exception at that time for any quality picture to be made at a cost of as little as \$850,000. [1013]

* * * * *

Q. I think we had reached the point where the question before the witness was whether he would, by the aid of referring to his notes, state what were the points in issue between himself and Mr. Schwab at this conference which they held concerning the

(Testimony of Herbert Freston.)

contract which ultimately became Exhibit 1 in this case.

A. I think I can give you all of those if you wish.

Q. Yes, if you will.

A. I have a sheet in my File 18465 here, marked Exhibit G for identification, all of which is in my own handwriting, marked at the right-hand top "8-27-45 O. B. Schwab and H. F.," referring to Oliver B. Schwab and [1017] Herbert Freston. On that sheet the following items appear:

"Paragraph 4-Budget. No approval necessary unless budget exceeds \$850,000, and if approval required, then as to budget as a whole and not as to separate items. If in excess of \$850,000, company will not be arbitrary or unreasonably withhold approval."

Opposite those two items I have marked: "See J. L. W.," meaning Jack L. Warner. And at the time I made those marks to indicate that those two items Mr. Schwab requested I had to obtain Mr. Warner's approval on.

Q. Did you call Mr. Warner?

A. I did.

Q. What was the conversation between you and Mr. Jack Warner?

A. He said that the clause as I read it to him was satisfactory.

Mr. Levy: That is Jack L. Warner?

The Witness: Jack L. Warner.

Q. (By Mr. Williams): Let me ask you this:

(Testimony of Herbert Freston.)

Why did you call Jack L. Warner rather than Harry Warner in connection with that matter?

A. Because Jack L. Warner is vice-president in charge of production. He has had long experience in the production of motion pictures, and since he is in charge of that activity at the studio and Mr. Harry M. Warner is not and is not a [1018] production man, necessarily I contacted J. L. Warner.

The second item deals with Paragraph 31st. My notes say: "May do outside picture if no default hereunder."

And a further note says: "This is 32 in final draft." Underneath that I have in my own handwriting: "See J. L. Warner."

Q. Did you see Jack L. Warner?

A. I did see J. L. Warner and he did approve of U. S. Pictures making an outside picture at some other studio so long as it was not in default under the provisions of the basic agreement.

Perhaps I had best explain, Mr. Williams, that the final draft of Exhibit 1 included, I think, an additional paragraph which was made in New York before the contract was signed which I did not have in my draft, and that accounts for the changes from 31 to 32, etc.

The next item dealt with material appearing on page 5 of the second draft of this contract which I had prepared. It says: "If producer buys literary property and company pays half of the cost, and if the property is not used by the producer, the pro-

(Testimony of Herbert Preston.)

ducer shall reimburse the company for the company's contribution toward the purchase price."

That provision was discussed between Mr. Schwab and me and was incorporated by me, at my request, in the final draft.

The next item deals with material appearing on page 1 [1019] of Exhibit 1 as it then stood. It says: "50-50 costs of production, but producer may, at its option, require company to contribute less than 50 per cent without otherwise affecting the pay-off, that is to say, 50 per cent to Warner and 50 per cent to producer under the deal." Opposite that item on this page I have these words: "Oliver to draft clause." And that was one of the clauses we agreed that Mr. Schwab would draft, and during that negotiation I had agreed with him that that would be satisfactory for Warner Bros.

Q. Was there anything stated as to the reasons for that clause?

A. Yes. Mr. Schwab said to me that it was quite likely that this enterprise would be successful and that the returns from one or more of the early pictures would come in in such amounts that U. S. Pictures would be in funds and therefore would like the opportunity of using that extra money toward production costs in excess of the 50 per cent. And I also think he explained to me that if U. S. Pictures had created a surplus and did not use it in connection with the production purposes, they might be subject to tax under Section 102 of the Internal Revenue Code, and therefore

(Testimony of Herbert Freston.)

they wanted to do something constructive with their money. I agreed with that problem.

The next memorandum, it says: "Lawsuits. If either [1020] party suffers any losses in re any picture re suits of third persons, defamation, privacy of literary property, etc., any such losses, including legal fees, borne equally by deducting from proceeds. If not sufficient proceeds, then the producer bears the loss."

And the memorandum opposite that provision shows the words: "Oliver to draft."

The next item dealt with the material appearing on page 24 of the second draft. We then had under discussion "re sale of stock. See notes. See J. L. Warner."

That clause, I believe, dealt with the right of U. S. Pictures to sell the stock to some other person, firm or corporation. It was my insistence that no such right be given because of the confidence that Warners had in the U. S. Pictures setup. We wanted to retain that organization and we provided, therefore, that the stock should not be sold except from one of the stockholders to the other.

The next item shows: "Page 1 in paragraph first. Producer may wish to make more than two pictures in any given year."

That was the subject under discussion.

The next item dealt with Section 41½ of Paragraph Seventh, page 14 of the second draft, merely a request to change "production overhead" to "op-

(Testimony of Herbert Freston.)

erating and general overhead." That request was made by Mr. Schwab. I agreed to it. [1021]

* * * * *

The next point in my memorandum states, page 5:

"Eliminate on line 5 the word 'necessarily.'"

I agreed with Mr. Schwab that the word "necessarily" might go out.

Q. Will you give us the language so we can understand what that was about?

A. Yes. On the top of page 5, the second draft, Exhibit G for identification:

"The Producer may, from time to time, in preparation for production and during the course of production, incur contractual obligations as an incident to its activities herein provided for, and provided such obligations or commitments are reasonably incurred in connection with such production program."

The word "reasonably" was stricken.

Mr. Levy: At Mr. Schwab's request?

The Witness: At Mr. Schwab's request, and I agreed with that. [1027]

My next item also states:

"Page 5, eliminate four lines, crossed out."

I have actually erased those four lines out of this draft of the second draft, which I actually did, but I may be able to find them for you in the first draft.

I do not have those four lines. They were actually erased by me, but in lieu of those four lines I

(Testimony of Herbert Freston.)

inserted a provision I wanted as a result of our conference and I will read it to you:

“Where the Producer shall enter into contracts with creative or artistic personnel, such as, but not limited to, directors, writers, actors, producers and the like, in connection with the preparation and production of the photoplays herein provided for, the Company will, on proper vouchers and billing from the Producer, pay to the Producer a sum equal to one-half of the moneys payable under such contracts, respectively, weekly, or from time to time, as such moneys become payable.”

I have then inserted the next four lines in my own handwriting in pen and ink, and reading as follows:

“But only for such services as may have been rendered by any such personnel in or in connection with any photoplay to be produced hereunder.”

The reasons for that I can give you, if you wish. [1028]

Q. (By Mr. Williams): What were the reasons for it?

A. The reasons were so the Producer couldn't load the pictures with a lot of talent of its own, and there was the same provision with respect to literary property. They had to be properties bought for use in one of the photoplays, or for artistic personnel employed to render services in one of these pictures.

* * * * * [1029]

(Testimony of Herbert Freston.)

The next item shows:

“Paragraph Fifth:”—I have quote marks around this:

“‘In notice required under paragraph Fourth, the Producer will notify the Company as to facilities required by it in production of each photoplay hereunder.’ This goes in and whole of Fifth eliminated.”

Q. (By Mr. Williams): Can you tell us what that particular matter was?

A. Yes. Paragraph Fifth as originally prepared by me and which was eliminated reads as follows:

“The Producer, within blank days prior to the date set for the commencement of production of any photoplay provided to be produced hereunder shall submit a budget of the facilities required for each of such photoplays so to be produced. Since the [1031] Company has agreed to pay one-half of the cost of production of each photoplay provided to be produced hereunder, and in order that it may be advised in advance of expenditure as to the nature and extent of its obligations hereunder, such budget and facilities required for each of said photoplays shall be subject to the approval of the Company, but in this connection the Company agrees that it will not be arbitrary or unreasonably withhold approval of any budget or any item in such budget.”

Mr. Levy: May I ask what page the witness was reading from in the exhibit?

(Testimony of Herbert Freston.)

The Witness: I am reading from page 8 of my second draft, and go over to the first line on page 9.

Mr. Levy: Thank you, sir.

The Witness: And all of that was eliminated as a result of the conference between Mr. Schwab and me, and in lieu of the elimination these words were inserted, or the substance of these words:

“‘In notice required under paragraph Fourth, the Producer will notify the Company as to the facilities required by it in the production of each photoplay hereunder.’ This goes in and whole of Fifth eliminated.”

And this was put in: [1032]

“‘In the notice from the Producer to the Company required under paragraph Fourth hereof, the Producer will notify the Company as to the facilities required by the Producer in connection with the production of each photoplay to be produced hereunder.” [1033]

* * * * *

Q. (By Mr. Williams): Let us go back before we proceed with what you did with that after the final draft, let us go back to the subject of where you got the material and information and phraseology for the making of this agreement which ultimately became Exhibit 1 in this case and which, in the form that you have before you, is Exhibit I for identification.

You did, did you not, look to certain material which you had on hand before you to get some of

(Testimony of Herbert Freston.)

the clauses and some of the ideas that are included in this agreement?

A. Yes, I did, many of the clauses which I call more [1041] or less standard clauses.

Q. To what sources did you look for the material and the form and the language that you finally incorporated in this agreement?

A. Some of the clauses and some of the language I took word for word out of the Curtiz draft.

Q. That is Exhibit H?

A. Exhibit H for identification.

Q. Yes. And from what other sources did you get either words or ideas?

A. Some ideas I got from the Bernhard memorandum having the highlights of the points that he and Mr. H. M. Warner had agreed upon with respect to the deal.

Q. That is memorandum that is in the bottom of Exhibit G for identification, is it?

A. Correct. And other paragraphs I wrote out myself or dictated. Many of them I wrote out myself in my own handwriting while the girl was copying the preceding paragraphs, in an effort to get this out in a hurry.

Q. Have you made an analysis of this agreement Exhibit 1 in this case for the purpose of determining the sources from which the various ideas and language which you placed therein were obtained? A. I have.

Q. And have you made notes of that for your own [1042] convenience in testifying?

(Testimony of Herbert Freston.)

A. I have.

Q. Do you have those notes with you?

A. I do.

Q. I presume that, without referring to the notes, it would be rather a long and arduous task for you to undertake to point out the source of each of the paragraphs of the final agreement, would it not?

A. In view of the fact that almost eight years has elapsed since I put this together, I would say that it is a very difficult task, Mr. Williams.

Q. Well, at any rate, by referring to the notes which you have made you can sufficiently refresh your recollection so you can testify as to the source of the matter contained in the agreement, can you not?

A. I believe I can.

Q. Now, with reference to the first paragraph, the introductory language in the first paragraph, what was the source of that language?

Mr. Levy: The first paragraph of what, Mr. Williams?

Mr. Williams: The introductory language in the first paragraph of the agreement Exhibit 1.

The Court: Has a schedule been made, a written schedule of these sources?

Mr. Williams: Yes, your Honor. [1043]

The Court: Does the witness testify that he made it?

The Witness: I made it, your Honor.

The Court: You have, out of court, compared

(Testimony of Herbert Freston.)

the contents of Exhibit 1 with the source material you used in drafting it?

The Witness: That is correct, your Honor.

The Court: You made a list of the sources with reference to the various parts of Exhibit 1?

The Witness: I have.

The Court: Do you have that with you?

The Witness: I do have it with me.

The Court: May it be introduced as the witness' testimony? [1044]

* * * * *

The Court: Very well. Then the document that we have been discussing may be received in evidence, and will be received as Defendants' Exhibit J, Mr. Clerk.

The Clerk: J, yes, your Honor.

(The document marked Defendants' Exhibit J, was received in evidence.)

Mr. Levy: Do I understand that I am to receive copies? [1048]

* * * * *

(Defendants' Exhibit J in evidence is copied into the record in the following words and figures, to-wit:)

Statement re Source Material

Counsel for the plaintiff in this case has submitted to some of the defendants certain detailed interrogatories dated October 28, 1952, and a number of the interrogatories presented make inquiries

Defendants' Exhibit J—(Continued)

as to the source material of certain provisions appearing in the WBPI-USPI Production-Distribution Agreement of September 28, 1945, hereinafter referred to as the "Basic Agreement." [1049]

As will be observed from the statement of Herbert Freston with reference to the circumstances leading up to the preparation of the basic agreement, the basic agreement in two or three drafts was drawn under great pressure and within a few days from the time the matter was submitted to us. The first draft of the document was turned out in one day until late at night of the same day.

In the nature of things, many of the provisions found in a production-distribution agreement are provisions prepared by counsel as a result of some years of experience in production-distribution set-ups. Many of the basic provisions in the form of production-distribution agreement used in 1945, and indeed being currently used, were formulated in the Legal Department of the New York office of WBPI, and to a great extent agreements prepared out here subsequently have more or less followed that form. Particularly is that so with respect to provisions concerning distribution of motion pictures, since the distribution headquarters is in New York City and the Legal Department there has had considerable contact with distribution matters.

At the time the basic agreement was prepared Herbert Freston had before him a copy of the old agreement drawn in this office between WBPI and

Defendants' Exhibit J—(Continued)

Frank Capra Productions, which latter agreement was not particularly helpful, but [1050] Herbert Freston also had before him a form of production-distribution agreement, in draft form only, prepared by R. J. Obringer in the Legal Department at the Studio. This was an early draft of a proposed production - distribution agreement between WBPI and Michael Curtiz Productions, which agreement, by the way, had not been placed in final form and had not been executed when the preparation of the basic agreement was commenced. The Michael Curtiz preliminary draft was never executed, but other drafts of that agreement were made and one of the drafts formulated by Mr. Obringer was finally signed by Michael Curtiz Productions and by WBPI, according to recollection, in 1946, and perhaps a year after the basic agreement was prepared. However, the Curtiz draft embodied many provisions which seemed to lend themselves to the arrangement between WBPI and USPI and, therefore, considerable recourse was had to that agreement. Accordingly, the Curtiz draft has been reexamined in connection with the basic agreement and its provisions, and in connection with the interrogatories of October 28, 1952, and a number of the answers given to certain of said interrogatories. This memorandum will endeavor to show what provisions in the basic agreement were taken from or based upon the Curtiz draft, and what provisions, found in the basic agreement, [1051] were drafted by Herbert Freston personally.

Defendants' Exhibit J—(Continued)

We will start with paragraph Second of the basic agreement:

Paragraph Second

The first 21 lines of paragraph Second of the basic agreement were taken from paragraph 5 of the Curtiz draft prepared by Obringer.

The last four lines of the first paragraph of paragraph Second of the basic agreement were also taken from the Curtiz draft with slight variations.

The next full paragraph of paragraph Second, commencing with the words "The Company shall keep a record of the cost of all facilities," and ending with the words "the photoplays herein referred to," was drafted by Herbert Freston in his own handwriting when revising the first draft of the basic agreement. (See this handwritten draft in File No. 18465).

The next paragraph of paragraph Second, page 4 of the basic agreement, beginning with the words "The Company shall contribute" and ending with the words "production of a picture," on page 5 of the basic agreement, was taken from a letter from Oliver Schwab dated August 28, 1945, to Herbert Freston, since at a previous conference between Herbert Freston and Schwab it was agreed that he would draft that clause. (See Schwab letter in H.F. [1052] File No. 18465).

The last seven lines of this same paragraph, on page 5 of the basic agreement, beginning with the words "provided, however, in any event," and ending with the words "paragraph Seventh hereof,"

Defendants' Exhibit J—(Continued)

were drafted by Herbert Freston in his own handwriting, and this handwritten draft is attached to the Schwab letter of August 28, 1945, in File No. 18465.

The next paragraph of paragraph Second, page 5 of the basic agreement, commencing with the words "The Company shall bill the Producer weekly," and ending with the words "as hereinafter provided for," was drafted by Herbert Freston in his own handwriting and this draft so written will be found in H. F. File No. 18465.

The last paragraph on page 5 of the basic agreement was also drafted by H. F. in his own handwriting and typing. (See work sheets in File No. 18465).

The first full paragraph at the top of page 6, down to the 13th line from the top, commencing with the words "one-half thereof," was also drafted by Herbert Freston in his own handwriting, for which see draft in File No. 18565.

(The above provision is referred to by Interrogatory 5—see page 62 of Answers to Interrogatories.) [1053]

The next five lines of this paragraph, beginning with the words "provided, however," and ending with the words "amount so paid," were drafted by Herbert Freston and appear in H. F. handwriting on page 5 of H. F.'s second draft of basic agreement, which in turn was based on suggestions made by Obringer to Herbert Freston.

Defendants' Exhibit J—(Continued)

(See Interrogatory 47 of Answers to Interrogatories, pages 63-64.)

The next 8 lines in this paragraph commencing with the words "where the Producer" and ending with the words "such moneys become payable" drafted by Herbert Freston. (See draft in H. F. handwriting in File No. 18465.)

Last 3 lines of this paragraph on page 6 of the basic agreement, commencing with the words "but only for" and ending with the words "being produced hereunder" were inserted by H. F. because of a suggestion made by Obringer, and draft of these 3 lines in handwriting of H. F. appears on page 5 of H. F.'s second draft in File No. 18465.

(See Interrogatory 49 and answers appearing on page 65 of Answers to Interrogatories.)

The last 2 lines on page 6, and the first 7 lines [1054] on page 7 of the basic agreement are based in part on Schwab letter to Herbert Freston of 8-28-45. These lines drafted by Herbert Freston. (See rider attached to page 5, H. F. second draft—File No. 18465).

Second paragraph on page 7 of basic agreement, commencing with the words "The Company agrees" and ending with the words "as such employer" drafted by Herbert Freston in own handwriting. (See this draft annexed to first draft of agreement in File No. 18465).

Paragraph Third

The first full paragraph of paragraph Third,

Defendants' Exhibit J—(Continued)

page 7, drafted by Herbert Freston. (See H. F. handwritten draft re first draft in File No. 18465).

Second paragraph of paragraph Third, appearing on pages 7 and 8 of the basic agreement, ending with the words "its own photoplays" also drafted by Herbert Freston in handwriting, and is in File No. 18465.

Paragraph Fourth

The first 10 lines on page 8 of the basic agreement were drafted by Herbert Freston and were based on paragraph 3 of the Memorandum dated August 17, 1945, dictated by Oliver Schwab and handed H. F. by Bernhard. This Memorandum of 8-17-45 will be hereinafter referred to as the "Bernhard Memorandum." For this draft by H. F., see Paragraph Fourth of H. F.'s [1055] first draft in File 18465.

The next 15 lines of paragraph Fourth, pages 8 and 9 of basic agreement, commencing with the words "final budget" and ending with the words "of the Producer" were based on changes made by Herbert Freston in budget provisions appearing in first draft following a conference between H. F. and Schwab on August 27, 1945. The change in budget provision as requested by Schwab was referred to J. L. Warner for his approval. (See H.F. notes on yellow sheet in H.F. handwriting dated "8-25-45—O.B.S. and H.F.—re submission of budget changes to J. L. Warner.")

The paragraph commencing on page 9 of the basic agreement, beginning with the words "since the

Defendants' Exhibit J—(Continued)

photoplays herein provided" and down to the sixth line from the top of page 10 ending with the words "provisions of this paragraph," drafted by Herbert Freston. (See H.F. yellow sheet covering this paragraph in connection with preparation of first draft).

The last 13 lines of paragraph Fourth on page 10 of the basic agreement were drafted by Herbert Freston. (See handwritten draft annexed to and following end of typed part of paragraph Fourth as shown in H. F.'s second draft in File 18465).

Paragraph Fifth

There is nothing of any moment in this paragraph found on page 10 of the basic agreement.

Paragraph Sixth

The whole of paragraph Sixth, page 10, down to and including the seventh line from the top of page 12 of the basic agreement, to and including the word "proper," was substantially taken from paragraph 13 of the Curtiz draft.

The seventh line from the top of page 12 of the basic agreement commencing with the word "provided," and the material included in the next six lines and ending with the words "individual contracts" drafted by Herbert Freston in own handwriting as a result of an agreement reached at a conference between H.F. and Schwab. (See H.F. handwritten memo in File 18465, listing points agreed on in H.F.-Schwab conference).

The last 8 lines of the first paragraph on page 12

Defendants' Exhibit J—(Continued)

of the basic agreement beginning with the words "The Company agrees" and ending with the words "the same party" are taken from paragraph 18 of the Curtiz draft.

The first 12 lines of the second paragraph on page 12 are, with minor variations, taken from paragraph 13 of the Curtiz draft. [1057]

The material on page 13, basic agreement, third line from the top of that page, commencing with the words "provided, however," to and including the words "of the Producer" in the sixth line from the bottom of paragraph Sixth, page 12, was drafted by Herbert Freston pursuant to paragraph 14 of the Bernhard Memorandum. (See H.F. handwritten draft of this provision attached to end of paragraph Sixth in H.F. first draft, File 18465.)

The last 6 lines of paragraph Sixth, page 12 of the basic agreement were taken from the last 7 lines of paragraph 13 of the Curtiz draft.

Paragraph Seventh

Paragraph Seventh of the basic agreement was taken from paragraph 12(a) of the Curtiz draft, with the exception of sub-paragraph 4½ appearing on page 15 and 16 of the basic agreement, and with the exception of the words "except the moneys set forth in subdivision 4½ of this paragraph, which moneys the Company shall pay or cause to be paid to the Producer," which appeared in the last two lines on page 13 and in the first line on page 14 of the basic agreement. Also excepting the refer-

Defendants' Exhibit J—(Continued)

ence to sub-paragraph 4½ in the sixth line from the top of page 14.

(Interrogatory 51, shown in the Answers [1058] to Interrogatories on page 66 is directed to this subparagraph 4½ found on page 15 and 16 of the basic contract.)

Subparagraph 4½ was drafted by Herbert Freston and was based upon paragraph 19-D and paragraph 20 of the Bernhard Memorandum. Paragraphs 19-D and 20 of the Bernhard Memorandum presumably were incorporated in that memorandum by Schwab at the direction of Bernhard as being one of the items that H. M. Warner and Bernhard agreed upon while they were discussing certain provisions which would be included in the basic agreement. H. F. did not raise any question as to whether or not such a provision was agreed upon between Messrs. Warner and Bernhard, but simply drafted clause 4½ of paragraph Seventh (a) because, so far as H. F. was concerned, it was one of the things that Warner and Bernhard had agreed to be incorporated in the basic agreement. (See draft of Section 4½ of paragraph Seventh (a) is in H. F.'s handwriting. See yellow memorandum in file marked "H.F." in file 18465.

Practically all of the provisions of paragraph Seventh (a), including subparagraphs (1) to (1) inclusive, but omitting subparagraph 4½, are more or less standard provisions appearing in the form of distribution contract in common use by WBPI, and, as [1059] above noted, these standard provi-

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sions were included in the Curtiz draft from which Seventh (a) largely was taken.

As above noted, Interrogatory 51, found on page 66 of the Answers to interrogatories, quotes paragraph 41½. Interrogatory 52, on page 66 of the Answers to Interrogatories, asks the question whether any such contract or contracts other than the WBPI-USPI basic agreement, entered into by Warner Bros., contained any provision substantially like or similar to the above-quoted Section 41½.

H. F. knows of no other contract, as finally executed by Warner Bros., which contained a clause similar to Section 41½. However, it should be noted that the Curtiz draft prepared some time in 1945, which H. F. had before him when preparing the basic agreement, in paragraph 14 (a), (IV), page 16, states:

“It is agreed, however, that the actual allocation of general overhead as herein concerned, shall be as determined by Price, Waterhouse & Co., certified Public Accountants, as the proper and fair charge to each photoplay, and shall be no greater than said Price, Waterhouse & Co. determines should be charged to other photoplays produced by Warner of similar type and [1060] comparable cost and importance.”

It should also be noted that this clause was taken from an early draft of the Curtiz contract, but when the Curtiz contract was finally executed by WBPI and by Curtiz Productions, that clause was

Defendants' Exhibit J—(Continued)

eliminated and a flat 35 per cent overhead rate was inserted instead.

It should also be noted that paragraph 14(a) (IV) of the Curtiz contract provides: The production cost shall further include the general overhead of the Producer as herein defined."

In another part of the contract, the Producer's overhead production costs were fixed at \$10,000 for each picture to be produced by Curtiz under the contract.

The obvious conclusion is that when the final Curtiz contract was negotiated, prior to execution the parties thereto could not agree upon the Price, Waterhouse provision and for that reason a flat overhead rate was provided for.

The last 9 lines of paragraph Seventh (a) found on page 17 of the basic agreement, relating to the Pierce, Waterhouse determination as to what the overhead should be, were drafted by H. F. in own handwriting. See this draft following paragraph Seventh (10) attached to the first draft in File 18465.

Subparagraph (b) of paragraph Seventh, page 18 of basic agreement, was copied from paragraph 14(b) of the Curtiz draft and appears on page 18 of that draft.

Paragraph Seventh (c), pages 18 and 19 of the basic agreement was copied from paragraph 14(c) of the Curtiz draft on pages 18 and 19 thereof.

Paragraph Seventh (d), pages 19 and 20 of basic

Defendants' Exhibit J—(Continued)

agreement was taken from paragraph 14(d), pages 19 and 20 of the Curtiz draft.

Paragraph Seventh (e), pages 20-21 of basic agreement was taken from paragraph 14(e), pages 20-21 of the Curtiz draft.

Paragraphs Seventh (f), (g), (h) and (i), pages 21 to 23 of the basic agreement were taken from paragraphs 14 (f), (g), (h) and (8), pages 21 to 23 of the Curtiz draft.

Paragraph Seventh (j) of the basic agreement was taken from paragraph 14(j) of the Curtiz draft, pages 23 and 24, with slight variations.

The first 13 lines of Seventh (k), pages 24 and 25 of the basic agreement were based upon paragraph 14 (k) of the Curtiz draft, page 25.

The material in paragraph Seventh (k), pages 25-26 of the basic agreement, commencing with the [1062] words "The Producer furthermore" in the tenth line from the top of page 25 of the basic agreement, to and including the words "commence thereon" on page 26 of the basic agreement, was drafted by Herbert Freston. (See notes of H.F. on this item on pages 23 and 24 of the second draft in File 18465).

Paragraph Eighth

The whole of paragraph Eighth, pages 26-28 of the basic agreement was taken from paragraph 15, pages 24-26 of the Curtiz draft.

Paragraph Ninth

That part of paragraph Ninth, page 28 of the

Defendants' Exhibit J—(Continued)

basic agreement from the beginning thereof down to and including the words "during such period" in the 13th line from the top of page 29 of the basic agreement, was taken from paragraph 17 of the Curtiz draft.

The last 11 lines of paragraph Ninth, page 29 of the basic agreement were drafted by Herbert Freston. (See H.F. handwritten draft pasted on page 27 of the first draft in File 18465.)

Paragraph Tenth

Paragraph Tenth, page 29 of the basic agreement, down to and including (c) on page 30 of the basic agreement was taken from and in large part based upon paragraph 18 of the Curtiz draft. (See H.F. [1063] notes on this on pages 29-30 of the first draft.)

The last 4 lines on page 30 of the basic agreement down to the middle of page 31, ending with the words "as the case may be" were drafted by Herbert Freston in own handwriting. (See handwritten draft attached to page 29 of second draft in File 18465.)

Paragraph Eleventh

Paragraph Eleventh, pages 31-2 of the basic agreement, taken in part from paragraph 19, page 32 of the Curtiz draft.

Paragraph Twelfth

Paragraph Twelfth, page 32 of the basic agreement was taken from paragraph 20, pages 32-3 of

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the Curtiz draft, except the last line of paragraph Twelfth, reading: "and to release any such picture as a photoplay of the Company." This quoted line was added by Herbert Freston. (See first draft for that addition in H.F. handwriting on page 31 of first draft.) [1064]

Paragraph Thirteenth

Paragraph Thirteenth for the most part, with slight variations, was taken from paragraph 21, pages 33 and 34 of the Curtiz draft.

The middle paragraph on page 33 of the basic agreement was taken from paragraph 21, page 34, of the Curtiz draft, but changed in accordance with the requirements of paragraph 4 of the Bernhard Memorandum.

The last paragraph commencing on page 33 of the basic agreement, with the words "The Producer understands," and ending with the words "with the Company" on page 34 of the basic agreement, was drafted by Herbert Freston in own handwriting. (See handwritten draft affixed to page 33 of the first draft in File 18465.)

The last 2 paragraphs of paragraph Thirteenth on page 34 of the basic agreement were taken from the Curtiz draft, paragraph 21, page 34.

Paragraph Fourteenth

The paragraph Fourteenth originally drafted by Herbert Freston on pages 34 and 35 of the basic agreement was eliminated from the contract and a

Defendants' Exhibit J—(Continued)

new paragraph Fourteenth was made a part of the contract in lieu thereof. This new paragraph Fourteenth apparently was drafted by Mr. Obringer and was signed by him on behalf of WBPI and by USPI, is in letter form, and is dated November 7, 1945. [1065] When the basic agreement was re-copied as a whole, in New York, the revised paragraph Fourteenth was copied in as a part of the basic contract and for that reason it appears in the photostatic copy as if it had originally been inserted therein in its present form in the first instance.

Paragraph Fifteenth

The first paragraph of paragraph Fifteenth of the basic agreement was drafted by Herbert Freston in his own handwriting. The first 13 lines of paragraph Fifteenth, in H.F. handwriting, are attached to paragraph Fifteenth of the second draft.

The remainder of said first paragraph commencing with the words "since the production of the photoplays" and down to and including the words "contracts or agreements" were also drafted by H.F. in his own handwriting, for which see handwritten draft attached to page 38 of the first draft in File 18465.

The last paragraph of paragraph Fifteenth appearing on page 35 of the basic agreement was also dictated and in part redrafted by Herbert Freston in his own handwriting. (See pages 34 of second draft.) The above provisions drafted by H.F. were in turn based upon certain provisions, changed

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somewhat, appearing in paragraph 25, pages 38 and 39 of the Curtiz draft. [1066]

Paragraph Sixteenth

This paragraph, with certain modifications, was based upon paragraph 26, page 39, of the Curtiz draft.

Paragraph Seventeenth

Paragraph Seventeenth of the basic agreement, pages 35 and 36, was based in part on paragraph 27, pages 39 and 40, of the Curtiz draft.

Paragraph Eighteenth

Paragraph Eighteenth of the basic agreement was in large part taken from paragraph 28, page 40, of the Curtiz draft.

Paragraph Nineteenth

Paragraph Nineteenth, pages 36-37, of the basic agreement was taken in part from paragraph 29, pages 40-41 of the Curtiz draft.

Paragraph Twentieth

Paragraph Twentieth of the basic agreement was substantially taken from and is based upon paragraph 30, pages 41 and 42 of the Curtiz draft.

Paragraph Twenty-First

Paragraph Twenty-first of the basic agreement was taken from paragraph 31, page 42 of the Curtiz draft.

Paragraph Twenty-Second

Paragraph Twenty-second of the basic agreement

Defendants' Exhibit J—(Continued)
was taken from paragraph 32, page 42, of the Curtiz draft. [1067]

Paragraph Twenty-Third

Paragraph Twenty-third of the basic agreement was taken from paragraph 33, page 42, of the Curtiz draft.

Paragraph Twenty-Fourth

Paragraph Twenty-fourth, page 39 of the basic agreement, was taken from paragraph 34, pages 42 and 43 of the Curtiz draft.

Paragraph Twenty-Fifth

Paragraph Twenty-fifth of the basic agreement was taken from paragraph 36, page 44 of the Curtiz draft.

Paragraph Twenty-Sixth

Paragraph Twenty-sixth of the basic agreement was taken from paragraph 37, page 44, of the Curtiz draft.

Paragraph Twenty-Seventh

The first full paragraph of Paragraph Twenty-Seventh, page 40 of the basic agreement was taken from or based upon paragraph 39, page 46 of the Curtiz draft.

The second paragraph of paragraph Twenty-Seventh relating to notices which the Producer may desire to give the Company was drafted by Herbert Freston and this clause appears in both the first and second drafts of the basic agreement in File 18465.

Defendants' Exhibit J—(Continued)

Paragraph Twenty-Eighth

Paragraph Twenty-eighth, page 41 of the basic agreement was in part based upon paragraph 40, page 46 of the Curtiz [1068] draft.

Paragraph Twenty-Ninth

Paragraph Twenty-ninth, pages 41 and 42 of the basic agreement was taken from paragraph 41, pages 46 and 47 of the Curtiz draft.

Paragraph Thirtieth

Paragraph Thirtieth of the basic agreement from the beginning thereof on page 42 to and including the words "distribution charges" on page 43, was taken in part from and was based upon paragraph 42, page 47 of the Curtiz draft.

The last paragraph of paragraph Thirtieth of the basic agreement, page 43, commencing with the words "if either the Company" and ending with the words "action or proceeding" was drafted by Schwab as a result of the conference between H.F. and Schwab held on October 27, 1945, and the material in said paragraph appears on pages 1 and 2 of Mr. Schwab's letter to H. F. dated August 28, 1945, in file 18465.

Paragraph Thirty-First

The first and second drafts of the basic agreement were prepared by Herbert Freston before he was advised that USPI intended to procure a loan from a bank from the purpose of financing its 50

Defendants' Exhibit J—(Continued)

per cent of the production costs of each picture. Theretofore H.F. had assumed, without knowing, that USPI would provide its own production costs. [1069] For instance, paragraph 9 of the Bernhard Memorandum states:

“Fifty per cent or such lesser sum as U.S. Pictures may require of the total negative costs of each of the pictures is to be lent by Warner Bros. to U.S. Pictures. The balance of production funds to be provided by U.S. Pictures.”

However, when the second draft of the contract was completed, in draft form for the purpose of submitting the draft to Mr. Bernhard and Mr. Schwab, H.F. was advised that arrangements have been made by Mr. Bernhard to borrow USPI's share of the production costs from a New York bank. Accordingly, after the second yellow paper draft had been completed in full, H.F. drafted a new paragraph and numbered it “Thirty-first.” This required the remaining paragraphs of the second yellow paper draft, from paragraph Thirty-second to Thirty-fifth, to be renumbered. Thus, paragraph Thirty-second became paragraph Thirty-third, and so on, ending the second draft with paragraph Thirty-sixth. Therefore, paragraph Thirty-first was drafted by Herbert Freston, and certain changes were made in said draft in the handwriting of Herbert Freston as shown on the draft of paragraph Thirty-first in the yellow paper second draft of the basic agreement in File 18465.

Said draft of paragraph Thirty-first, as [1070]

Defendants' Exhibit J—(Continued)

prepared by Herbert Freston, was incorporated in the final basic agreement as paragraph Thirty-first.

On November 8, 1945, long after H.F.'s work on the basic agreement was completed, he received a letter dated November 6, 1945, from Stanleigh P. Friedman, New York. In that letter Mr. Friedman told H.F. that Friedman had closed a loan for USPI from the New York Trust Company for the purpose of supplying USPI's share of the production costs. In the course of his letter to H.F., Mr. Friedman stated:

"In the course of agreeing upon the language of the various documents required, it seemed advisable for us to change the language of Section Thirty-first of the Basic Agreement. That clause of Section Thirty-first in which Warner Bros. agrees to subordinate its claim for cash and facilities advanced by it to the bank's claim for priority in the repayment of moneys advanced by the bank, seemed to us to come very close to contravening the inhibition in the Warner \$37,000,000 bank loan agreement. The reasoning is as follows:

"The Warner bank loan agreement (2) (a) provides that Warner will not permit a [1071] lien or encumbrance upon any account receivable; to subordinate its account receivable from United States Pictures to the prior payment of the Bank's loan is almost equivalent to permitting an encumbrance upon Warner's account receivable. In view of the foregoing, United States Pictures, with the consent of The New York Trust Company, entered

Defendants' Exhibit J—(Continued)

into a Letter Agreement of November 2, 1945, amending the Basic Agreement of September 28, 1945 (this is the new date of this agreement) a copy of which is enclosed herewith. The Letter Agreement revises the language of the one paragraph in Section Thirty-first so as to make it benign in the light of the \$37,000,000 bank loan agreement.

“In order that you may guide yourself as to the inhibitory clauses of the bank loan agreement, I am enclosing herewith a copy for your files.”

The Letter Agreement referred to by Mr. Friedman in his letter amended paragraph Thirty-first of the basic agreement as prepared by H. F., said Letter Agreement being as follows:

“November 2, 1945. [1072]

“Warner Bros. Pictures, Inc.,
New York, N.Y.

Dear Sirs:

Referring to the agreement between us dated September 28, 1945, it is agreed that the next to the last paragraph of paragraph Thirty-first shall be amended to read as follows:

‘If said bank loan shall be made, as aforesaid, in connection with any photoplay, then in order that said bank may be reimbursed for the amount of its loan, principal and interest, in accordance with the foregoing, the Company agrees that the Producer or its assignee will be entitled to receive all of the gross receipts of such photoplay less distribution

Defendants' Exhibit J—(Continued)

fees and expenses until Producer or its assignee has received the amount of the bank loan with interest thereon pertaining to such photoplay and the Company agrees that until such time it will pay such balance of the gross receipts of the bank in liquidation of such loan. The distribution fees and expenses which shall be deducted as just set forth shall be those specified in subdivisions (1), (2), (3), (5), (6), (7) and (8) [1073] of said paragraph Seventh (a) and as set forth in subdivision (a) to (c) inclusive of paragraph Seventeenth hereof.'

Very truly yours,

United States Pictures, Inc.

By Jos. Bernhard, President

Agreed to: Warner Bros. Pictures, Inc. By Stanleigh P. Friedman, Vice-President.

Consented to: The New York Trust Company, By Willis McDonald, Vice-President."

At the time H. F. prepared paragraph Thirty-first of the basic agreement he did not know of the loan agreement which WBPI had with the New York banks and, of course, not having seen the agreement, he did not know that there was any provision in that agreement prohibiting Warner Bros. from placing any lien or encumbrance upon any of its accounts receivable or of subordinating its accounts receivable until the New York bank had been repaid the amount of its loan. Had he

Defendants' Exhibit J—(Continued)

known that at the time, H.F. would, of course, not have prepared paragraph Thirty-first in the manner he did. In any event, paragraph Thirty-first was amended in New York as shown above, and this eliminated any possible violation of the Warner Loan Agreement with the New York bank.

H.F. understands that plaintiff's counsel endeavored to make some point of the fact that paragraph Thirty-first may have contravened the provisions of the Warner Loan Agreement with the New York Bank. H.S. was informed—the source of the information not being presently recalled,—that Messrs. White and Case of New York represented the New York Trust Company in bringing about this amendment to paragraph Thirty-first, and that afterward Messrs. White and Case expressed the opinion that Paragraph Thirty-first of the basic agreement, as amended, did not violate the Warner Loan Agreement with the New York banks.

Paragraph Thirty-Second

Paragraph Thirty-second, page 47 of the basic agreement was drafted by Herbert Freston and was based upon paragraph 21 of the Bernhard Memorandum. Schwab said USPI would like to have the right to do an outside picture so long as it was not in default under the basic agreement. This request was submitted to J. L. Warner by H.F. for approval, and upon his approval being given was written into the final draft. [1075]

Defendants' Exhibit J—(Continued)

Paragraph Thirty-Third

Paragraph Thirty-third, page 47 of the basic agreement was taken from paragraph 44, page 48 of the Curtiz draft.

Paragraph Thirty-Fourth

Paragraph Thirty-fourth, page 47 of the basic agreement was taken from paragraph 45, page 48 of the Curtiz draft.

Paragraph Thirty-Fifth

Paragraph Thirty-fifth of the basic agreement, page 47, was taken from paragraph 46, page 48 of the Curtiz draft.

Paragraph Thirty-Sixth

Paragraph Thirty-sixth of the basic agreement was inserted in the agreement in New York when the basic agreement was rewritten. This paragraph simply made the agreement effective on and after November 7, 1945.

Paragraph Thirty-Seventh

Paragraph Thirty-seventh, pages 47 and 48 of the basic agreement—which was paragraph Thirty-sixth in H. F.'s final draft—was based upon paragraph 47, page 48, of the Curtiz draft.

Schedule A to the contract was simply copied from a form submitted by the New York office, which same form was annexed to the Curtiz draft as Exhibit B. This was a standard schedule supplied by counsel of the office of [1076] distributor in New York.

Exhibit or Schedule B to the basic contract was

Defendants' Exhibit J—(Continued)

the letter from Price, Waterhouse & Co. establishing the overhead charge to USPI for the furnishing by WPBI of production facilities.

H.F. does not recall ever seeing the Price, Waterhouse letter, Schedule B to the basic agreement, until after the contract was fully prepared by H.F. in final form.

On page 17 of the basic agreement, H.F. simply included a provision in his own handwriting to the effect that the Price, Waterhouse letter should be attached to the agreement as Schedule B. [1077]

* * * * *

Q. Now, we will then proceed to another subject. Having completed what you regarded as the final draft of what is now Exhibit No. 1, what did you next do with that draft?

A. Well, in the interim I had several more conferences, I think with one of the Warners or perhaps both of them, I think perhaps with Mr. Schwab, perhaps with Mr. Bernhard. I have notes on all of this showing to whom I talked and when and where. And after the agreement was finally finished in the form that I have it here, referring to Exhibit I for identification, I took that out to the studio, where I had a conference with H. M. and J. L. Warner for about two hours.

Q. And what was the substance of that conference?

A. I went over this agreement from beginning to end with them, both of them. During the course—I did not read it all. Some clauses I read. I ex-

(Testimony of Herbert Freston.)

plained to each of them what the clauses meant, what they said in a general way, and during the course of that explanation both of them asked me a number of questions about it. I endeavored to answer those questions. And that was on the 30th of August, 1945.

Q. Was there any other person present at that time?

A. I don't remember whether there were or not, but my offhand recollection is that both Warners were there, maybe Bernhard was there. I can tell by looking at my documents.

Q. Will you look at your documents and tell me, Mr. Freston, what documents are you now looking at?

A. These are my personal office time sheets concerning the time spent by me on all phases of the preparation of this agreement and its explanation to the clients. [1079]

* * * * *

Q. By referring to those will you tell us who were present at these conferences?

A. You mean in the August 30th conference?

Q. Well, whatever the conferences that involved the consideration of this agreement after you got it in draft form.

A. All right. On the 21st of August, which was the day after I completed the first draft of this document, I was enroute to and at the studio from 3:15 until a quarter of 6:00 that night. And at the studio, my notes say—and I verily believe they are

(Testimony of Herbert Freston.)

correct—I talked with H. M. Warner, J. M. Bernhard and Milton Sperling about this agreement and the terms of it.

On the 22nd of August I was engaged in revising that agreement from a quarter of 10:00 in the morning until 11:15 that night.

On the 22nd of August I was again engaged in revising [1080] the agreement.

On the 24th of August I was working on the agreement yet, and on the 24th of August at between 1:30 and 5:00 o'clock I was at the studio for a conference with H. M. Warner, J. L. Warner, Joe Bernhard, Milton Sperling, and Oliver Schwab with reference to this contract.

On the 27th of August from 1:15 to 3:00 o'clock I had a conference in our office with Mr. Oliver Schwab.

Q. That is the conference to which you have already testified?

A. To which I have referred heretofore. Also I see I spent an hour and a half in the morning on that day working on this agreement.

On the 28th of August my record shows I only spent 15 minutes in looking over certain changes in the agreement.

On the 29th of August I worked about three hours on it for some reason or other.

On the 30th day of August from 12:00 to 1:00 o'clock, my notes show reading the agreement, etc., in preparation for a trip to the studio to see J. L. Warner and Joe Bernhard. My notes show also that

(Testimony of Herbert Freston.)

from 1:15 until 4:30 I was enroute to and at the studio for conferences with H. M. Warner, J. L. Warner, Joe Bernhard, Obringer, and Schwab with reference to the agreement. Now, I cannot recall at this time whether Mr. Obringer or Mr. Schwab were there, but nevertheless, it [1081] was my understanding that I was going there to see them.

On the 31st of August, which was the day following the final conference I had at the studio with the brothers Warner, my time sheet shows that I spent 30 minutes only in making changes in my file copy of the agreement, and there was one change that was made in the agreement on August 30th at the final conference I had with the brothers Warner that was more than a mere typographical change.

Q. What was that change?

A. And that was the change of the distribution charge set forth in subdivision (1) of the paragraph Seventh (a) from 15 per cent to 20 per cent. I did not rewrite the contract for the purpose of showing that change in typing, but I merely interlineated above, struck out the word "f-i-f-t-e-e-n", and had my secretary type the word "t-w-e-n-t-y," struck out the figures "15 per cent" and had my secretary insert above that the typewritten numbers "20 per cent." And that is the change—that is one of the changes that were made as the result of the conference with the brothers Warner on the 30th of August, 1945. [1082]

* * * * *

Q. What is the practice of banks with reference

(Testimony of Herbert Freston.)

to the matter of security required and the time and manner of repayment of loans to independent producers? A. It is the normal——

Mr. Levy: Just a moment.

The Witness: Pardon me.

Mr. Levy: I object to the question as to the practice of banks generally. I don't see that it has any relevancy on the issue we are trying here, the practice of banks.

If counsel were to confine the question to bring it right close home, does this situation, namely, the transaction that was involved here between the New York Trust Company and Warner, if the question were directed to what the demands of the New York Trust Company were with respect to this particular transaction, the question would not be objectionable.

The Court: Is the purpose of it to show the witness' understanding at the time he drafted the agreement? [1084]

Mr. Williams: The purpose is to show the witness' understanding at the time he drafted the agreement.

The Court: Why don't you pass the question in that form instead of attempting to prove the fact?

Mr. Williams: I thought I had, if your Honor please; but, in addition to that, I also will want to prove the fact with reference to the practice of banks, because the issue in this case has been raised that this matter of subordinating the Warner Bros.' right to get money to that of the bank was a very

(Testimony of Herbert Freston.)

terrible thing for the benefit of Harry Warner's son-in-law.

It is my purpose to prove there has never been, so far as this witness and many others I am prepared to call, there has never been a case in which a bank ever did lend any money in which it did not require the deposit of the negative and require that this money should come first after the distribution fee and expenses.

In other words, to show that that was a settled practice. [1085]

* * * * *

Q. Do you know, Mr. Freston, whether at the time you drafted what is now Exhibit 1 in this case, whether there was at that time a practice of banks in reference to the security required and the terms of repayment of loans made to independent producers? A. I do.

Q. You were aware of that at that time?

A. I was. [1086]

The Court: Very well. The question is what you understood those requirements to be at the time you drafted Exhibit 1, as I understand it.

The Witness: That is correct. The bank would generally want to see that a proper commitment had been made to distribute the picture. That is one of the first requisites.

The Court: A reliable distributor?

The Witness: A reliable distributor.

The bank then would insist as a condition precedent to its loan that the negative and prints gen-

(Testimony of Herbert Freston.)

erally be pledged or hypothecated for the benefit of securing the bank in the repayment of the amount of its loan with interest.

The Court: Would that include the mortgage of the copyright?

The Witness: I don't recall whether the pledge agreement goes so far as to cover the copyright or not, [1092] but they do do it. We have one in the Capra situation which would show that.

The bank also insists, and this is a very common requirement, that where an independent producer makes a picture on a major lot for major distribution, that there shall be an unconditional guarantee of completion of that picture by the major producer.

The banks also insist that the money payable to the bank or the money coming to the bank in repayment of its loan, principal and interest, shall come out first.

The Court: That is, out of the first proceeds of distribution?

The Witness: That is correct; out of the first proceeds of distribution, with the sole exception only of the distribution costs and things of that sort which enables a distributor to distribute, but the next money goes to the bank until the bank is repaid in full, principal and interest. [1093]

* * * * *

The Court: Do you have any knowledge as to the requirements of New York banks?

The Witness: I have no knowledge as to the

(Testimony of Herbert Freston.)

[1094] requirements of New York banks except the knowledge that I have obtained from this very deal, I might say to your Honor. [1095]

* * * * *

Q. (By Mr. Williams): Mr. Freston, at the time you drew this agreement, Exhibit 1, without going into any specific details, did you have the intention at that time of making an agreement which would be especially for the benefit of Mr. Sperling, and to the same extent unfair to Warner Bros. Pictures, Inc.? [1099]

* * * * *

A. It was my intention to draw an agreement that was perfectly fair to my own client as well as to United States Pictures. In paragraph 31 I simply made out the common program that has been used in banking loans for many years. It doesn't favor one or the other. The bank is the only one that is favored, really.

* * * * *

Q. (By Mr. Williams): The question I asked, which I think probably I did not make clear enough, I was referring to paragraph 31 specifically, and I was referring to the entire agreement, Exhibit 1 in this case, and I ask you whether at the time you were drafting this agreement you had the intention to draft an agreement which [1100] would specially favor Mr. Sperling or United States Pictures, or either of them, and to the same extent would be detrimental to Warner Bros. Pictures, Inc.?

(Testimony of Herbert Freston.)

A. I had no such intention, Mr. Williams.

* * * * *

Q. Was it your intention in drafting this agreement, and in the drafting of it, to make an agreement which would fairly protect the interests and safeguard the rights of Warner Bros. Pictures, Inc.?

A. That was my intention. [1101]

* * * * *

Q. Did any person who discussed the matter of this agreement with you while you were drafting it or at any time in connection with the drafting of it make any statement to you which you understood to be a request or suggestion that you should unduly favor United States Pictures or Milton Sperling to the detriment of Warner Bros. in connection with this deal?

A. Nobody made any such statement, Mr. Williams, at any time.

I might say to you this agreement is largely my own idea. [1103] I put it the way I thought it should be. [1104]

* * * * *

Q. (By Mr. Williams): Was there any act, verbal or otherwise, or anything done or said by any person in connection with this matter, which you understood to be a request or an intention or a suggestion that you should favor Milton Sperling to any extent, or United States Pictures to any extent, in the matter of drafting this agreement?

A. Nothing was said by anybody on any phase of any such situation at any time.

(Testimony of Herbert Freston.)

The Court: Do you mean that your answer is "No"?

The Witness: I mean that my answer is "No," your Honor. I find it difficult to explain this, but, as a matter [1105] of fact, I constructed this agreement myself. Nobody told me what to put in it——

* * * * *

Q. (By Mr. Williams): Mr. Freston, what information did you have during the time you were drafting this contract as to what, if anything, had been decided by anybody with reference to the salaries of Milton Sperling and Joseph Bernhard?

A. I was told what they were by H. M. Warner.

Q. And what were you told?

A. I was told they were to be \$1,000 a week, which he had approved.

The Court: Did you understand that to mean that Sperling—and who is the other man?

The Witness: Bernhard. [1111]

The Court: —and Bernhard had agreed between them that they would have a salary each of \$1,000 a week, and that H. M. Warner had approved that arrangement?

The Witness: That is what I understood, that it was an approval all around, that it was an agreement all around that their salaries would be that amount.

Mr. Levy: May we have the date of that discussion?

The Witness: Well, Mr. Levy, it is somewhere between August 21 and August 30 of 1945.

(Testimony of Herbert Freston.)

Mr. Levy: Yes, sir.

Q. (By Mr. Williams): And was it at one of these conversations that you have already testified that you had with H. M. Warner?

A. Yes. [1112]

* * * * *

The Court: It calls for "belief." Sustained. Do you mean to inquire whether, according to this witness' understanding at the time he drafted Exhibit 1, it was anything unusual for a company such as Warner Bros. to enter into such an arrangement as this with an independent producer of such limited capital?

Mr. Williams: Yes.

The Court: Is there objection to the question in that form?

Mr. Levy: If the question is asked in that form, I have no objection to it.

Mr. Williams: May I adopt that question as my question, your Honor?

The Court: You may if the witness understands it.

The Witness: Would you read it, please, Mr. Bargion?

(Question read by the reporter.) [1116]

A. It was not unusual, your Honor. It was the customary thing.

The Court: That was your understanding at the time?

The Witness: That was my understanding and it always has been. * * * * * [1117]

STANLEIGH P. FRIEDMAN

called as a witness on behalf of defendants, having been duly sworn, testified as follows:

The Clerk: Will you state your name to the court?

The Witness: Stanleigh P. Friedman, S-t-a-n-l-e-i-g-h P. F-r-i-e-d-m-a-n.

The Clerk: Your address?

The Witness: 321 West 44th Street, New York City, New York.

Direct Examination

Q. (By Mr. Williams): Mr. Friedman, what is your occupation? A. I am a lawyer.

Q. How long have you been a lawyer?

A. I was admitted to the bar of New York in 1907.

Q. Have you been practicing in New York since that time?

A. No; I graduated from Harvard Law School and have practiced continuously from then until the present time. [1125]

Q. Your offices are in New York City?

A. Correct.

Q. To what courts are you admitted to practice?

A. The United States Supreme Court, the courts of New York, the United States District Court, the Circuit Court of Appeals for the Second Circuit, and your Ninth Circuit Court of Appeals.

Mr. Williams: I wanted to bring out the Ninth Circuit Court of Appeals, your Honor, so that he is not completely a foreigner. I think, if I may, I

(Testimony of Stanleigh P. Friedman.)

ought to, in fixing the qualifications of this witness, call attention to the fact that he is the author of the famous Downfield, the fighting son of Yale University, and three others of the athletic songs regularly played. I am sure that will assist the court in appraising his qualifications.

The Witness: A good musician among lawyers and a good lawyer among musicians.

Q. Mr. Friedman, you are one of the attorneys for Warner Bros. Pictures, Inc.? A. Yes.

Q. How long have you been an attorney for that corporation?

A. Since its inception in April, 1923.

Q. As a matter of fact, you organized the corporation, did you not, you and your partners?

A. My firm, Thomas & Friedman.

Q. Are you a director of Warner Bros.?

A. Yes, sir.

Q. How long have you been a director of Warner Bros.? A. 1930 to date.

Q. In addition to that, do you occupy any office in the company? A. I am vice president.

Q. How long have you been a vice president of Warner Bros.?

A. 1935 or 1936. Since 1935 or 1936.

Q. Where do you make your headquarters with reference to the offices of the company?

A. 321 West 44th Street, New York City.

Q. That is in the same building?

A. In the Warner Building.

(Testimony of Stanleigh P. Friedman.)

Q. Do you devote substantially all of your time to the affairs of Warner Bros. Pictures, Inc.?

A. Yes.

Q. In addition to yourself, what are the other lawyers in New York who represent the company?

A. Our general counsel is Robert W. Perkins. We have six or seven other members of the legal department.

Q. What particular branch of the work do you specialize in? [1127]

A. I have charge of all taxes, federal, state and city and foreign taxes. I have reasonable charge of the litigating department on litigated matters, with the exception of antitrust matters. I have much to do with all the banking arrangements which Warners have had with various banks since the inception of the company. I have much to do with SEC, the Securities and Exchange Commission transactions, and with other corporate activities as such.

Q. In the normal course of your business, do you yourself have anything to do with the drafting or the passing on of contracts of independent producers with Warner Bros. Pictures?

A. No.

Q. Who in Warner Bros. usually takes care of that?

A. Mr. Bareford; Harold Bareford; who, with Mr. Perkins have most to do with these contracts of distribution, and I might add Mr. Ebenstein; contracts where there are independent producers or

(Testimony of Stanleigh P. Friedman.)

in which actors have a share of the profits, but it is beyond the general ambit of my duties.

Q. In the fall of 1945, that is, in the months of August and September, was Mr. Bareford available at the New York offices?

A. No; Mr. Bareford was in the service of his country. [1128]

Q. During that period did you receive from the Burbank Studios a draft of a contract between United States Pictures and Warner Bros. Pictures, Inc.?

A. I did.

Q. You are familiar with the document which has been marked as Plaintiff's Exhibit 1 in this case, are you not?

A. Yes.

Q. Was the document which you received at that time substantially what that Plaintiff's Exhibit 1 now is?

A. Yes.

Q. At the time you received it, what did you do with it?

A. I personally made a thorough analysis of it, which was so long that my friends made fun of me because the analysis was almost as long as the contract itself.

Q. In other words, you made a written analysis?

A. I made a written analysis of every paragraph.

Q. In the course of going over that contract, did you arrange for any changes to be made in it, or suggest any changes in it?

A. I did, a couple of changes, after talking it over with Mr. Perkins and having checked on it

(Testimony of Stanleigh P. Friedman.)

in other ways. I made some minor corrections, and one of them is the correction that Mr. Freston adverted to about the paragraph, I think it is the one toward the end where the [1129] contract was not to begin its operation until November 7, 1945.

I also made a change in the paragraph having to do with the production of pictures outside the studio, for outside distribution, and I think the original contract shows interlineation in my handwriting, but it is entirely inconsequential.

Q. Was the contract then typed up for signature in New York? A. It was.

Q. In connection with going over this contract, did you discuss the contract or its terms with any of the other people then at Warner in New York?

A. I discussed it with Mr. Perkins. I discussed it with Mr. Schneider, who was then at the coast, by long distance telephone.

Q. Do you remember what phase or phases of the contract you discussed with Mr. Schneider?

A. I asked about certain questions with which I was somewhat unfamiliar, namely, the amount of distribution expense, distribution allowance, particularly, and my memory doesn't serve me accurately as to whether there were any other matters in that contract, any other paragraphs or provisions in that contract as to which I had any doubt, but I did have some doubt about that provision, [1130] because I was unfamiliar with the terms for distribution allowance.

(Testimony of Stanleigh P. Friedman.)

Q. Do you remember the substance of the conversation you had with Mr. Schneider?

A. Yes. I vaguely remember that I asked him if 20 per cent was the usual allowance. I had heard of another contract where the distribution allowance was $17\frac{1}{2}$ per cent and I had thought that perhaps this was a little high. I wanted to make sure that it was correct.

I was told by Mr. Schneider that it was.

Q. Did you discuss the terms of the contract with anybody else that you now remember besides Mr. Schneider and Mr. Perkins?

A. Yes, I had a telephone conversation with Mr. Freston about it, but I have forgotten on what subject.

Q. You don't remember, then, having discussed it with anybody besides these three men you have mentioned at that time?

A. I discussed it with Major Albert Warner in order to acquaint him with some of the details of the contract, because he was the one to present it at the meeting of the board of directors where it was to be submitted for consideration.

Q. Were you present at the meeting when the contract [1131] was submitted for consideration?

A. Yes.

Q. What happened at that meeting, so far as this contract is concerned?

A. Mr. Warner, Albert Warner, who presided at the meeting, and usually presides at the meetings in New York, stated at that time, at the time

(Testimony of Stanleigh P. Friedman.)

of the meeting, we had before us a resignation of Mr. Joseph Bernhard as a director and vice president.

He told us at that time, which was the fact, that we were in the process of drafting an agreement with a company which Bernhard had formed, and which was to include Mr. Sperling, and that this agreement would provide for the production of pictures by an independent group, namely, Sperling and Bernhard and their corporation for distribution by Warner Bros. Pictures.

Then the meeting simply proceeded to the consideration of the resignation and the question of the severance pay for one or two of the men who had withdrawn from the company at that time, including Mr. Bernhard.

Q. Do you remember the name of the other person for whom severance pay was provided at that time?

A. I think it was Charles Einfeld, who was then head of our publicity department.

Mr. Levy: May I have the question read by the [1132] reporter?

(Question read.)

Q. (By Mr. Williams): Incidentally, before we get to the matters about——

Mr. Levy: You say "at that time." Do you mean at that meeting?

Mr. Williams: Yes, at that meeting. You have got the minutes that show that, Mr. Levy.

The Court: Proceed.

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: I am sorry. You were misinterpreting the registry of my face.

Q. (By Mr. Williams): In that connection may I ask you whether it is or is not a fact that Warner Bros. Pictures, Inc. in the past, preceding 1945, through the years has provided severance pay for all the employees who have left the service of the company? A. That is a fact.

Q. In reference to Bernhard's severance pay, was there anything unusual in the practice of the company in his being provided with six months' severance pay?

Mr. Levy: I object to the form of the question on the ground it is compound.

The Court: And do you object on the ground it calls for his conclusion?

Mr. Levy: And I object on the ground it calls [1133] for his conclusion.

The Court: Sustained. I take it you are asking again for understanding.

Mr. Williams: No; I am asking for the practice, whether this was in accordance with the practice. That is what I am asking.

The Court: Sustained.

Q. (By Mr. Williams): Was anything said in reference to Mr. Bernhard's severance pay that it was a condition to this United States Pictures contract that was being made?

A. Not at all. It was our practice to provide severance pay for our employees who had been with the company for a long period of time.

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: I move to strike the latter part of the witness' answer.

The Court: Motion granted.

Q. (By Mr. Williams): Was there a practice in Warner Bros. Pictures, Inc. to provide severance pay in case of employees of executive character who left after long service?

Mr. Levy: I object to the question on the ground it has no bearing upon this particular issue and on the ground it calls for a conclusion.

The Court: Objection overruled. You may answer. [1134]

Mr. Williams: Will you read the question?

(Question read.)

A. Yes.

The Court: I take it you are referring to some particular time——

Mr. Williams: At the time in 1945, yes. I am talking about the practice at the time——

The Witness: Yes; and for years prior thereto.

Q. What was that practice?

A. Six months' pay.

The Court: The company would give a retiring employee six months' severance pay?

The Witness: Correct.

The Court: Did that apply to all employees?

The Witness: Executive employees who had been with the company for many years.

The Court: How many years?

The Witness: I would say ten years.

Q. (By Mr. Williams): In the case of Mr.

(Testimony of Stanleigh P. Friedman.)

Bernhard, he had been with the company more than ten years at that time, had he not?

A. My recollection is that Mr. Bernhard came to the company in 1930 or 1931.

Q. And had been with them continuously——

A. And had been with them continuously with the [1135] exception of a period when he went into the Navy. He was called upon to render expert services to the United States Navy, during which time he was given a leave of absence of some months.

Q. Was it at the meeting on the 25th of September, 1945, that this matter of Mr. Bernhard's resignation and his severance pay was passed on by the Board?

A. That is my recollection, as refreshed by the minutes and the various depositions that I have read.

Q. Was it at that meeting that Mr. Albert Warner explained what you have already testified about the proposed contract with United States Pictures? A. In general.

Q. Yes. Following that meeting on the 28th of September, the record shows there was another meeting of the Board of Directors. Were you present at this second meeting?

A. Yes, I was.

Q. What was done, if anything, with reference to this United States Pictures contract at that meeting?

A. Mr. Warner, who presided—Albert Warner

(Testimony of Stanleigh P. Friedman.)

—said that I had made a study of it and would make available to the members of the Board the contents of the agreement, which I did at length.

Q. Did you have a copy of the agreement with you? [1136]

A. Yes, I had a copy of the agreement with me on the table.

Q. In addition to that, did you have some other document?

A. I had my short analysis of it.

Mr. Levy: When you say "short,," you smile; is that what you mean?

The Witness: I say "short" with a smile.

Mr. Levy: I see.

Q. (By Mr. Williams): You had the analysis that you have heretofore referred to that they joked about being almost as long as the agreement?

A. That is right.

Q. At that time, in the presence of the members of the Board, state as fully as you can now remember what you told them with reference to the contents, the substance and the effect of this agreement.

A. I didn't read every paragraph from my analysis, nor of the contract. I skimmed over the contract with my analysis and pointed up the important parts of it, and some questions were asked of me, and I had put myself in a position to be able to answer them, which I did. Some of the directors asked questions about the production—one of them, Mr. Catchings, asked about the pro-

(Testimony of Stanleigh P. Friedman.)

duction of an outside picture, and I was able to explain that. [1137] Someone asked what was the meaning of the word "reasonable" in connection with salaries of the producers.

I remember that Mr. Albert Warner said he had been informed that each of the men, Sperling and Bernhard, had agreed at that time for the present to draw a thousand dollars a week, but my memory doesn't serve me very much as to the other questions.

I think Mr. Guggenheimer asked me a question, but I can't remember what it was.

May I add——

Q. Yes.

A. Of course, the inside directors, those who are employees of the company, were acquainted with the contract. I had discussed it with Mr. Carlisle, and, of course, Mr. Perkins, and Mr. Schneider wasn't there at the meeting. He was at the Coast at the time, but Mr. Perkins and Mr. Carlisle and I, of course, knew the terms and knew the contract and its provisions.

Mr. Levy: I move to strike the latter part of the witness' statement with respect to Mr. Carlisle knowing the terms of the contract and Mr. Perkins knowing the terms of the contract. [1138]

The Witness: I discussed it with both of them.

The Court: Motion granted.

Mr. Williams: As to what they knew only?

The Court: Yes.

Mr. Levy: That's right.

(Testimony of Stanleigh P. Friedman.)

Mr. Williams: You are not striking the part where he said he discussed it with both of them?

The Court: No, the motion was not directed to that.

Mr. Levy: That is right, your Honor.

Q. (By Mr. Williams): About how long a time was taken up in your explanation of the terms of the contract to the board?

A. About an hour; but that is purely based upon the best of my recollection as to time. I didn't time it.

Q. I understand that.

A. The average witness doesn't know the passage of time, anyway.

Q. Did you, Mr. Friedman, endeavor to make a complete explanation of all of the terms of the agreement which you consider to be pertinent to the question whether the agreement should or should not be passed by the board?

Mr. Levy: Mr. Friedman, just a moment, I object to the question on the ground it is immaterial as to the endeavors of the witness.

The Court: Sustained. [1139]

Mr. Williams: Here is a case, if your Honor please, where fraud is alleged.

The Court: You can ask him what he understood he did.

Mr. Williams: That is exactly what I am asking him.

The Court: No, you have asked him, "Did you endeavor?" That is an equivocal term, possibly.

(Testimony of Stanleigh P. Friedman.)

Mr. Williams: Every term is equivocal when Mr. Levy comes to discussing it.

Mr. Levy: I am sorry, Mr. Williams, but——

The Court: Intend and understand are two terms pretty well settled in the law.

Mr. Levy: I would like to clear myself on the record.

The Court: You don't need to defend yourself, Mr. Levy.

Mr. Levy: Thank you.

Q. (By Mr. Williams): Was it your intention, Mr. Friedman, at the time you explained this matter to the board to fully and fairly explain all of the terms of the agreement to them so that they would have a clear understanding of the character and effect of the contract? A. It was.

Q. Was it your understanding you would so explain it to the board?

A. I understood it; I believed it. [1140]

Q. After you had explained the matter to the board and the questions had been asked, was there any action taken by the board?

A. The board enacted a resolution, the precise language of which you have in the minutes.

Q. Did you vote in favor of that resolution?

A. I believe I did.

Q. At that time was it your intention to vote on a contract which would be for the benefit of Warner Bros. Pictures, Inc.? A. I did.

Q. Did you understand in making your vote

(Testimony of Stanleigh P. Friedman.)

that you were voting on a contract which was for the benefit of Warner Bros. Pictures, Inc.?

A. I did.

Q. Had anybody at any time prior to your vote in any manner, by word, act or deed suggest or intimate to you how you should vote on that resolution?

A. Positively no.

Q. Harry Warner or Jack Warner were not present then, were they?

A. No.

Q. Had you talked with Jack Warner about that contract before you presented it to the board?

A. No, I had not. [1141]

Q. Had you talked with Harry Warner before you proceeded to present it to the board?

A. I had a telephone conversation with Mr. Harry Warner long before the contract was sent to New York——

Mr. Levy: May we have an identification of which Warner?

A. I said I had a telephone conversation with Mr. Harry Warner long before the contract was sent to New York in which he told me that he had been talking with Mr. Bernhard, Mr. Sperling, Mr. Freston and Mr. Schneider and he reminded me that, he mentioned it to me, that he was trying to put together a deal by which the company, Warner Bros. Pictures, Inc., could have the benefit of this independent producer production group to make pictures on the Warner lot for Warner distribution, but he never discussed this contract with me.

(Testimony of Stanleigh P. Friedman.)

Q. Did he at that time make any statement to you with reference to how you should vote on it, if it ever came before you as a director?

A. No.

Q. Now, Mr. Friedman, did you know who Mr. Sperling was at the time of this?

A. Indeed I did.

Q. Was there any discussion before the board as to who Mr. Sperling was, either on the 25th or 28th of September? [1142]

A. There was no discussion, but someone raised the question of what Mr. Sperling's experience had been in the production field. It was answered by Mr. Warner and by me.

Q. What was the substance of what you and Mr. Warner said at that time?

A. Both Mr. Warner and I——

Q. You are referring to Mr. Albert Warner?

A. I am referring to Mr. Albert Warner. Both Mr. Albert Warner and I were aware that Milton Sperling before he went into the service——

The Court: Just what was said in substance at the board meeting?

The Witness: We stated, either Mr. Warner or I stated to the board that Mr. Sperling had been employed by Fox, or 20th Century-Fox, as it afterwards became, prior to going into the service and that he had produced to co-produced certain well known pictures and among them was the outstanding picture *To the Shores of Tripoli*, and now, relying completely on recollection which may have

(Testimony of Stanleigh P. Friedman.)

been colored by the fact that I read depositions since that time, but I do remember that he made a picture with Sonia Henie who was then a very well known skater. There might have been other pictures produced by Mr. Sperling which were stated by Mr. Warner or by me to the board but I can't recall what they were. I cannot reconstruct the meeting sufficiently to [1143] state that those other pictures were named to the board, but everyone of the members of the board of directors knew Mr. Sperling. They all knew who he was and had been acquainted with him.

Mr. Levy: The latter part of the witness' answer is a little confusing. I don't know whether the witness intends to connote by his answer whether the other members of the board knew that Mr. Sperling had done this or the other thing, or just knew impersonally.

The Witness: Just knew impersonally.

The Court: According to your understanding they all knew he was the son-in-law of Harry Warner?

The Witness: They all knew he was the son-in-law of Harry Warner and were all personally acquainted with Mr. Sperling. They had probably all been to his wedding.

The Court: According to your understanding.

The Witness: According to my belief and understanding. [1144]

Q. (By Mr. Williams): Mr. Friedman, what was your opinion as to whether or not Milton Sper-

(Testimony of Stanleigh P. Friedman.)

ling being the son-in-law of Harry M. Warner should be counted in favor of him or against him at that time, I mean from the standpoint of the company?

A. Oh, from the standpoint of the company I thought it was a very advantageous fact and factor that we would have an independent producer of Milton's caliber, who was related to the president of our company and under such a status of regard by Jack L. Warner as I knew he was.

Q. Was there any person at the meeting of the board of directors which approved this contract who voiced any opposition to the contract?

A. No.

Q. Following the passage of the resolution by the board did you have anything to do with the contract after that?

A. I signed the contract.

Q. You signed it following the meeting at which it was authorized? A. Correct.

The Court: You signed it on behalf of the corporation?

The Witness: On behalf of the corporation. I am a signing officer of the corporation.

Q. (By Mr. Williams): Mr. Friedman, in the course of [1145] business of Warner Bros. Pictures, Inc., when a contract is executed such as that is there any procedure which is followed by the corporation in distributing copies of the contract to certain persons?

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: I object to the question—withdraw the objection.

A. The practice is for the executive officers or the lawyers who procure the signatures to contracts to send them to what is called our “trust department” where we keep all original papers; and that is what I did with this contract in this case.

Q. (By Mr. Williams): Do you know what the practice of the trust department is with reference to acquainting other departments of the fact and terms of the contract?

Mr. Levy: May it please the court, I have no objection to the witness answering that question yes or no; but if it is going to proceed from that point on and the witness is going to testify as to the moves that are made, the various acts passing back and forth that contract and all of that sort of thing, I will object to it.

Mr. Williams: We haven’t got to that point.

Mr. Levy: Very well.

The Court: You may answer the pending question, Mr. Friedman.

The Witness: May the reporter, please? [1146]
(Question read by the reporter.)

A. I do.

The Court: The question relates to September of 1945?

Mr. Williams: To September of 1945.

A. Of it I am sure.

Q. (By Mr. Williams): At that time what was that practice, Mr. Friedman?

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: If the court please, I object to what the practice was at that time. Of course, I would be in no position to object if the witness can state with authority what was done with this particular contract.

The Court: I take it the purpose of it is to show the ordinary course of business. Of course, I assume they would rely then upon the disputable presumption that the ordinary course of business was followed. Is that your purpose?

Mr. Williams: Yes, your Honor.

The Court: You may answer.

A. In general, the contract is skeletonized and copies of the analysis, the digest of the contract, is sent to various departments of the business, and the contracts are immediately photostated and several copies are retained in the trust department files and other copies are sent around to the various departments that will be concerned with the administration of it.

Q. (By Mr. Williams): In the case of a production-distribution [1147] contract what departments are, in the course of business, affected by the contract?

A. Well, in the first place, the production department; secondly, the distribution department; thirdly, the financing department, Mr. Martin, Mr. Carlisle.

Q. How about the accounting department?

A. And the legal department. Well, the finan-

(Testimony of Stanleigh P. Friedman.)

cial is the accounting department, and then the legal department keeps a copy in the files.

Q. Do you have any personal knowledge with reference to this particular contract whether it followed that course?

A. I think it did, but I haven't any—I can't make the statement definitely. [1148]

* * * * *

STANLEIGH P. FRIEDMAN

the witness on the stand at the time of adjournment, was recalled and testified further as follows:

Direct Examination—(Resumed)

Q. (By Mr. Williams): Mr. Friedman, are you familiar with the basic loan agreement between Warner Bros. Pictures and the syndicate of banks headed by the New York Trust Company, which has been marked Exhibit 11 in this case?

A. Just tell me the date.

Mr. Williams: Perhaps the clerk will show Exhibit 11 to Mr. Friedman.

The Court: Exhibit 11, according to Exhibit 102 for [1168] identification, the list, is a loan agreement dated July 21, 1943, between Warner Bros. Pictures, Inc. and a syndicate of banks, the First National Bank of Boston, etcetera and et al.

Mr. Williams: The clerk has now handed the exhibit to the witness, your Honor.

The Witness: I collaborated in the preparation of this document, and I was then familiar with the terms. I am acquainted with it, but I don't know

(Testimony of Stanleigh P. Friedman.)

whether I am familar with the terms at this late date. * * * * *

Q. Did you examine Exhibit No. 1 with reference to the question of whether there might be or was an apparent or actual conflict between the provisions of that [1169] agreement and the agreement Exhibit 11? A. Yes.

Q. Did you form an opinion on that subject at that time? A. Yes.

Q. What was that opinion?

A. That the agreement of September, 1945, between Warner Bros. Pictures, Inc. and United States Pictures did not contravene the terms of the bank loan agreement.

The Court: Exhibit 11?

The Witness: Exhibit 11, and subsequent bank loan agreements which were then in existence.

* * * * * [1170]

Q. Did you, in addition to studying this matter and forming your own opinion, discuss the matter with any attorney representing the banks?

A. Yes.

Q. What attorney was that?

A. Al Houston of White & Case.

Q. Did he give you an opinion on that subject?

A. Yes. [1171]

Q. Was that opinion given to you orally?

A. Orally.

Q. Was there later a writing?

A. It was confirmed in writing.

Mr. Williams: May I point out, if your Honor

(Testimony of Stanleigh P. Friedman.)

please, that the letter from White & Case which is referred to has been marked in this case No. 16. I believe that is in evidence already, your Honor.

Mr. Levy: Plaintiff's Exhibit 16.

Mr. Williams: May the witness examine Plaintiff's Exhibit 16?

Q. I show you now Plaintiff's Exhibit 16 and ask you whether that is a photostat copy of the letter you received from White & Case in reference to this matter, and concerning which you have just testified? A. Yes, it is.

Mr. Williams: I am going to refer now to the matter of the so-called Hemisphere agreement, which has been marked in evidence in this case as Exhibit 3-A. May the witness have an opportunity to examine that agreement? May the witness also examine Exhibit 3 together with 3-A, at the same time?

The Court: Yes.

Q. (By Mr. Williams): You have before you now [1172] Exhibit 3, which is an amendment to the basic agreement and an amendment of the agreement between Warner Bros. and United States Pictures dated May 20, 1946, and also 3-A, which is an agreement between United States Pictures and the Hemisphere Company. Did you at any time examine those agreements? A. I did.

Q. About when was it that you examined the agreements?

A. When they were sent on from the Coast, and I think about the date of the agreements.

(Testimony of Stanleigh P. Friedman.)

Q. Yes.

A. I can be sure of that by having a reference to the minutes of the Board of Directors at which this amendment to the basic agreement with regard to Hemisphere Films was enacted or was considered.

Q. If I call your attention to Exhibit 20 in this case——

The Court: Mr. Clerk: Will you place Exhibit 20 in front of the witness?

The Clerk: Yes, your Honor.

Q. (By Mr. Williams): You have before you now Exhibit 20, which is the record, or extracts from the minutes of a special meeting of the Board of Directors of Warner Bros. held on June 18, 1946. Are those the minutes to which you refer that would [1173] help you in answering the question as to the time when you examined Exhibits 3 and 3-A?

A. It states to my satisfaction that I had received the amendatory agreement between Warner Bros. Pictures, Inc. and United States Pictures at or shortly after the date of the agreement, May, 1946, and then I made an analysis of it, a complete analysis of it, in a little bit shorter form, which I presented to Major Warner and Mr. Schneider, which discloses the results of the change as it affected Warner Bros. Pictures, Inc.

Q. Will you state what character of analysis you did make?

A. I have before me a document, which bears date July 2, 1946, and that will give you a very good idea of what type of analysis I made.

(Testimony of Stanleigh P. Friedman.)

The Court: Is that a document heretofore marked?

Mr. Williams: No, it has not been marked, if your Honor please. It might be marked for identification.

Q. Would you refer to that, and from that could you give us a statement of what the details of your analysis were?

The Court: Mr. Clerk, will you mark the document the witness now has as Defendants' Exhibit L for identification.

Mr. Levy: May I glance at it for a moment, your Honor? [1174]

The Court: Yes.

The Clerk: So marked.

(The document referred to was marked Defendants' Exhibit L for identification.)

The Court: Please hand it to counsel.

Mr. Levy: Thank you.

The Witness: May I have the question, Mr. Reporter?

(Question read.)

The Witness: I could.

Q. (By Mr. Williams): Will you do so, then?

A. This is a memorandum which I prepared at the time:

"The deal between Warner, U.S. Pictures and Hemisphere Films, Inc., a newly organized California corporation, the numerical control of whose stock is owned by U.S. Pictures, is on the following basis:

(Testimony of Stanleigh P. Friedman.)

“The basic agreement between Warner and U.S. Pictures is to be amended so as to provide that the second of the six pictures which U.S. contracted to produce for Warner shall be the picture *Pursued*, which will be produced by Hemisphere on the Warner lot.

“U.S. will lend to Hemisphere 50 per cent of all cost of production which amount U.S. will [1175] borrow in cash and facilities from Warner. The other 50 per cent Hemisphere will borrow from The New York Trust Company. U.S. Pictures and Warner will enter into an agreement with the bank under which the first moneys from the gross receipts of the picture, after deducting distribution fees and expenses, will be paid to the bank until the loan with interest is paid. The profits of the picture will be divided one-third to Warner and two-thirds to Hemisphere (one-half of which will go to U.S. by reason of its ownership of approximately half of the stock of Hemisphere). This compares with the terms of the original U.S.-Warner basic agreement under which Warner would be entitled to 50 per cent of the profits.

“It is estimated that the difference between 50 per cent of the profits which Warner would be entitled to receive under the original agreement with U.S., and the 33-1/3 per cent which it will now receive on the new arrangement covering the picture *Pursued* will be somewhat made up by the following:

(Testimony of Stanleigh P. Friedman.)

“(i) Warner’s participation in increased distribution charges. [1176]

“Under the original basic agreement Warner is entitled to distribution charges of 20 per cent domestic and 25 per cent England, etc. The new agreement with Hemisphere provides that the distribution charge for domestic shall be increased to 25 per cent and for England to 30 per cent, with varying rates for the rest of the world as provided in the original basic agreement between U.S. and Warner. This differential of 20 per cent is to be split 50-50 between U.S. and Warner.

“(ii) Warner’s participation in increased overhead charges in respect of this picture:

“U.S. will provide stage space and ‘facilities’ for Hemisphere on the Warner lot and charge Hemisphere as overhead 45 per cent of all direct cost items of the picture. This compares with a probable average overhead charge of 25 per cent which U.S. Pictures now pays to Warner under its basic agreement with Warner. The differential of 20 per cent will be divided equally between U.S. Pictures and Warner.

“(iii) Warner’s equal participation in a 15 per cent service charge on national advertising, interest to be charged on advances, and \$50,000 to be deducted from profit before Hemisphere [1177] participates therein.

“U.S. Pictures in its agreement with Hemisphere will charge the latter a service charge of 15 per cent on the national advertising of the picture,

(Testimony of Stanleigh P. Friedman.)

interest on its advances at the same rate as paid for the bank loan, and will also deduct from the profits \$50,000. These amounts will be equally divided between U.S. Pictures and Warner.

“Of course, increased distribution and overhead charges will diminish the net profits in which we share. Such profit is also adversely affected by an item of \$17,500 for U.S. Pictures and Hemisphere lawyers fees charged to the cost of the picture.

“Mr. Carlisle has made computations on a hypothetical \$2,500,000 gross for the picture and his figures show that Warner will receive practically the same financial benefit on the new basis as on the old. (\$175,000 on the old against \$167,000 on the new). He has also made computations on a basis of \$3,000,000 gross and on such basis Warner would get somewhat more on the old basis than on the new (\$362,500 on the old basis against \$308,000 on the new). His figures are herewith [1178] presented. It should be noted that the larger the gross income the greater the disparity between old and new basis becomes.

“U.S. and Warner each give up the same amount to make the deal on Pursued and share equally in the net return from the production and distribution of the picture.

“If the transaction is approved, please let me know so that I can complete the preparaton of the necessary papers.”

Subjoined to this is a typewritten note:

“Mr. Albert Warner in the presence of Mr.

(Testimony of Stanleigh P. Friedman.)

Schneider authorized S. P. Friedman to proceed with the deal according to this memorandum."

Appended to which is a computation handed to me by Mr. Carlisle: "Assuming World Gross of \$2,500,000," a comparison of the old basis and the new basis; and the second sheet: "Assuming World Gross of \$3,000,000," a comparison of old basis and new basis. [1179]

Q. Did you understand in connection with this deal who were involved in Hemisphere, what personalities were involved in Hemisphere?

A. I was aware.

Q. And who were those persons?

A. Teresa Wright, who played a very important role in Mrs. Miniver, and Niven Busch, her husband, who was the author of the screen play Pursued.

Q. Was any information given to you as to what, if any, were the demands of Niven Busch and Teresa Wright as to the use of the play and the service of Wright? A. Yes.

Q. From whom did you get that information?

Mr. Levy: Just a moment. I object to the form unless the witness states about when and where and the circumstances.

Mr. Williams: We are getting to that. I can only do it one at a time.

Mr. Levy: Very well, Mr. Williams.

The Witness: The question, please, Mr. Reporter.

Mr. Williams: The first question was who gave the information.

A. I believe a telephone conversation with Mr.

(Testimony of Stanleigh P. Friedman.)

Schwab or Mr. Sperling, but I am very hazy in my recollection of who told me about it.

Q. What were you told? [1180]

A. I was told that this was the deal which the Hemisphere people—which Niven Busch and Teresa Wright were willing to enter into to make this picture with the use of Niven Busch's script.

Q. When were you given that information?

A. At or about the time of the transaction.

Q. Were you given the information before the matter came on before the board of directors of the company? A. Yes.

Q. Were you present at the board meeting when this deal was approved? A. Yes.

Q. The meeting of June 18th? A. Yes.

Q. And was there any discussion of the deal among the directors at that time?

A. There was none.

Q. Was there any explanation of the deal to the directors?

Mr. Levy: Just a moment, please. The witness said "There was none." Does the witness mean no discussion?

The Witness: There was no discussion.

Q. (By Mr. Williams): Was there any explanation of the deal to the directors at that meeting?

A. Yes, I made the explanation of the deal.

Q. Can you state generally what you stated to the board at that time?

A. Relying on my memory, again, I stated to the board that it was proposed to substitute Pur-

(Testimony of Stanleigh P. Friedman.)

sued for the second picture in the production schedule of United States Pictures, Inc.; that the Hemisphere Corporation had been formed between United States Pictures and Wright and Niven Busch and that this picture Pursued would be the second picture in the program of production by United States Pictures. I explained the terms pretty much the same as I explained them in my memorandum to Mr. Warner and Mr. Schneider.

The Court: That is Exhibit L for identification?

The Witness: That is Exhibit L for identification.

Q. (By Mr. Williams): At the time you considered this matter and voted on it did you understand at that time that in order to obtain this story and the services of Teresa Wright it was necessary to make a deal of the character that was involved in this contract? A. Yes.

Q. Did you understand that unless a deal of that character were made, that neither the story nor the services of Miss Wright could be obtained?

Mr. Levy: Just a moment. I did not object to the previous question, your Honor, but this question goes one step further. I think the previous question was to the effect: [1182] Did you understand—well, I forget just what the exact wording was. Now we are going beyond that point, where the witness has to speculate on what a lot of other people had in mind.

The Court: The question merely calls for his understanding. Of course, you may cross examine

(Testimony of Stanleigh P. Friedman.)

him fully on the basis of that understanding if you wish.

Mr. Levy: Very well, your Honor.

The Witness: The question, please.

(Question read by the reporter.)

The Court: You may answer.

A. Yes, that was my understanding.

Q. (By Mr. Williams): Did you understand in voting for this transaction as a director that you were voting for a transaction which was favorable to the interests of Warner Bros. Pictures, Inc.?

A. Yes.

Q. And was it your intention to vote for a transaction which would be for the interests of that company?

A. It was.

Q. Mr. Friedman, I call your attention to the meeting of the board of directors of Warner Bros. Pictures, Inc. which is evidenced by an exhibit in this case, Exhibit No.—I am referring to the meeting of August 17, 1950.

A. I remember the occasion of the meeting, Mr. Williams. [1183]

Q. Oh, yes, that is August 17, 1950, Exhibit No. 23.

A. I remember the meeting of August 17, 1950.

Q. You remember the meeting. That is the meeting at which there was brought up the matter of an extension or an amendment to the basic agreement between United States Pictures and Warner Bros. Pictures, and also some reference to the amendment of December 6, 1947?

(Testimony of Stanleigh P. Friedman.)

A. I remember the meeting.

Q. Yes. Were you present at that meeting?

A. I was.

Q. And prior to the meeting did you have any information as to this matter being brought before the meeting?

A. I was on my holiday down at Nantucket Island, Massachusetts and Mr. Perkins, our general counsel, called me on the telephone and said that it was proposed that there be a further extension of the United States Pictures-Warner program and asked for my oral approval. And I told him that it certainly met with my approval. But the meeting was not held until I got back, and when I got back to New York that meeting was held and the resolution which is in the minutes was enacted by the board of directors.

Q. Was that matter explained to the board there at the time of the meeting?

A. Well, I——

Mr. Levy: Does he know which matter you are referring [1184] to, Mr. Williams?

Mr. Williams: The extension agreement.

A. The extension agreements were stated to the board and what was proposed to do.

Q. You voted in favor of that, did you?

A. I did.

Q. Did all the other directors vote in favor of it?

A. They did.

Q. Did you understand at that time in voting to that effect that you were voting for a matter

(Testimony of Stanleigh P. Friedman.)

which was for the benefit of Warner Bros. Pictures, Inc.?

A. Yes.

Q. And did you intend in so voting to take action favorable to the interests of Warner Bros. Pictures, Inc.?

A. I did so intend.

Q. Now I call your attention to the stockholders meeting of 1946, that was held in November 1946, and in particular to the notice of meeting and proxy statement accompanying it, dated January 10, 1946, which is Exhibit No. 21 in this case. Are you familiar with that proxy statement?

A. I am familiar with the proxy statement and the notice.

Q. Did you have anything to do with the preparation of the proxy statement?

A. I collaborated in the preparation of it.

Q. And in particular, with reference to that portion of the proxy statement which recites the terms of the deal between Warner Bros. and United States Pictures and the bank arrangements that were being made, did you assist in the drafting of that particular portion of it?

A. Yes, yes.

Q. May I ask you what was the purpose of putting this particular transaction into the proxy statement?

A. To conform with the rules of the Security Exchange Commission which required a statement of all transactions with directors.

Q. And because Bernhard had been a director?

A. And because Bernhard had been a director.

(Testimony of Stanleigh P. Friedman.)

Q. Were you present at the meeting of the stockholders which followed? A. Yes, sir.

Q. Was there any objection made by any person to this transaction at that time?

Mr. Levy: Just a moment. That is assuming a state of facts not in evidence: Was there any objection?

Mr. Williams: I am just about to put them in evidence.

Mr. Levy: Was there any objection made by any person to the——

Mr. Williams: At the hearing.

Mr. Levy: ——to the contract Exhibit 1, is that what [1186] you said?

Mr. Williams: Yes.

Mr. Levy: Well, there is no evidence that the matter was brought before the meeting of the stockholders of Warner Bros.

Mr. Williams: The proxy statement itself is in evidence, showing that the members——

The Court: Is the purport of your question to ask the witness did he hear at the stockholders meeting any objection voiced?

Mr. Williams: Any objection voiced.

The Court: To Exhibit 1. Is there objection to the question in that form?

Mr. Levy: May it please the court, we have not in evidence—it seems that we have in evidence all of the stockholders meetings of Warner Bros. beginning with 1947 down to the present, but we

(Testimony of Stanleigh P. Friedman.)

haven't in evidence the minutes of the stockholders meeting of 1946. The witness is being asked——

The Court: Where is that? Where are the minutes of that meeting?

Mr. Levy: I do not know.

Mr. Williams: You never asked for them. We provided counsel with everything they asked for.

The Court: Are they available?

Mr. Williams: They could be available on a day's notice [1187] or so. We have provided counsel with everything they asked for.

Mr. Levy: I believe that I asked for all of the meetings of the stockholders. Maybe I am in error. But, if you will examine my——

The Court: You may have been confused on the year. Do you wish them now?

Mr. Levy: It is possible that I was confused, your Honor.

Mr. Williams: We will get them for him.

Mr. Levy: But the only reason I made the objection, your Honor, is this: I have read the minutes of the stockholders meetings each and every year.

The Court: Including the year 1946?

Mr. Levy: No, your Honor; those that are in evidence, beginning with the year 1947. And when the witness was asked the question: Was any objection raised by any stockholder, I was in the dark and what I wanted to know was—what I wanted to make sure was that the question did not assume a state of facts not in evidence, namely, if

(Testimony of Stanleigh P. Friedman.)

the question had not been brought up at the stockholders meeting at all, to ask a witness a question: Did anybody object to it? would be just producing information, that is, gathering information into this record which would be contrary to the actual fact. And that is the only reason why I interposed the objection and that was why I was careful to note the form of Mr. [1188] Williams' question. Otherwise it would just pass by.

The Court: Do you wish the minutes produced of the 1946 meeting of the stockholders?

Mr. Levy: Yes, your Honor. I have not seen them. I do not know what is in them, but I am quite sure that under the circumstances they would be informative.

The Court: Can they be here tomorrow?

Mr. Williams: They can be here tomorrow.

The Witness: You have got copies here?

Mr. Williams: Not the 1946.

The Witness: You will have to telegraph New York for them.

Mr. Levy: Well, I have no objection to the witness' recollection presently, under the circumstances, until they can be supplied, as long as the witness who was at the meeting will say: This proposition was brought up, et cetera, et cetera, and what transpired. I have no objection to that.

The Witness: Very good. * * * * *

The Court: The question, as I understand it, is this: Did the witness hear at that meeting any ob-

(Testimony of Stanleigh P. Friedman.)

jection voiced to the transaction which is embodied in Exhibit 1? [1189]

Mr. Levy: Assuming such transaction was presented to the stockholders.

The Court: No, without assuming anything.

Mr. Williams: Without assuming anything.

The Court: Except there was a meeting, he was present, and did he hear——

Mr. Levy: Any objection?

The Court: ——any objection voiced, and you may cross examine him on it.

Mr. Levy: Very well, your Honor.

The Court: You may answer.

A. My answer, heretofore given, is that no objection was voiced by anybody at the meeting of the stockholders.

Mr. Williams: You may cross examine.

The Court: Before we leave the subject of the minutes——

Mr. Williams: We will get them as soon as we can. I thought we might possibly have a copy in my office, but if we have not, we will telegraph to New York for them today.

The Court: Very well.

Mr. Williams: I assume a copy is all that is necessary.

Mr. Levy: Surely. * * * * * [1190]

Cross Examination

Q. (By Mr. Levy): Taking that last meeting up that we just referred to, Mr. Friedman, before

(Testimony of Stanleigh P. Friedman.)

we go any further, you were present at that meeting?

Q. You are referring to the stockholders meeting?

Q. Yes, of 1946? A. Yes, I was.

Q. Was the question presented at all to the stockholders, namely, the agreement between United States Pictures and Warner Bros. Pictures?

A. I am in doubt about that.

Q. In other words, did anybody get up and say—— A. Excuse me. I did not——

Q. ——an agreement has been entered into between our corporation and Warner Bros. Pictures, and this, that or the other, thing are parts of the agreement? Did anybody say anything like it?

A. I am in doubt about it, but I believe that Judge Morris, Hugh Morris, former Federal Judge in Wilmington, Delaware, who presided at the meeting read a memorandum which might have—I believe it did—mention the fact that the contract such as advised to our stockholders in the proxy statement had been entered into between the corporation and United States Pictures. [1191]

Q. Mr. Friedman, you were present at that meeting? A. Yes.

Q. In your opinion, Mr. Friedman, had you been a stockholder who was merely attending that meeting, without any previous knowledge of any of the doings of the corporation, but having before you merely the proxy statement and having read carefully, for that matter, the proxy statement and

(Testimony of Stanleigh P. Friedman.)

having heard whatever was said by whomsoever who said it, in your opinion would you have known the substance of the agreement between Warner Bros. Pictures and United States Pictures?

Mr. Williams: That question is objected to on the ground it calls for conclusion and speculation on the part of the witness, and incompetent, irrelevant and immaterial.

The Court: Objection sustained.

Q. (By Mr. Levy): Were you a stockholder?

A. Yes.

Q. Of Warner Bros.? A. Yes.

Q. I understood you to say that you collaborated on the drawing of the proxy statement—right?

A. I do not know what your understanding was, but I so stated.

Q. And with whom did you collaborate in the drawing of that proxy statement? [1192]

A. With Mr. Perkins, Mr. Bareford and Mr. Hessberg. Bareford and Hessberg are lawyers and assistant secretary. Mr. Perkins is general counsel.

Q. Yes. * * * * *

Mr. Williams: 21, your Honor, is the proxy statement.

Mr. Levy: Yes, that is the one I referred to, 21.
* * * * *

Q. (By Mr. Levy): Now, Mr. Friedman, on page 3 of [1193] Exhibit 21, you testified that the paragraph of that exhibit which is headed by the words "Transactions between the corporation and directors," which proceeds down to almost the bot-

(Testimony of Stanleigh P. Friedman.)

tom of the page of that exhibit and which is followed by another paragraph making reference to the loan agreement between Warner Bros. and The New York Trust Company, which continues on to the top of the following page of this exhibit—I understand that you were the author; is that what you want us to understand, that you authored that, that language?

A. Your question is what you understand. What I testified to was that I collaborated.

Q. Did you author that language?

A. I collaborated in the language.

Q. And the object of both of these paragraphs was merely to satisfy SEC regulations, is that correct?

A. That is one of the objects, and the other object is to advise the stockholders of the transactions.

Q. You say that that was one other object of those two particular paragraphs?

A. Correct.

Q. To advise the stockholders of what, Mr. Friedman?

A. To put them on inquiry if they wished further notice, to advise them that there were these transactions with directors. [1194]

Q. With directors?

A. With directors.

Q. But with nobody else, is that right?

A. No one else?

Q. That was close to the corporation?

(Testimony of Stanleigh P. Friedman.)

A. I beg pardon.

Q. With nobody else. These paragraphs were not directed to putting the stockholders on notice that a son-in-law of the chief executive of Warner Bros. is or was to be connected with the particular transaction covered by these two paragraphs?

A. Well, certainly——

Q. That was not an object, was it?

A. No, that was not an object.

Q. You knew at the time, of course, as you testified that Milton Sperling was going into partnership or to be half-owner of stock of United States Pictures, did you not? A. Correct.

Q. And you did not think, did you, it necessary for the stockholders to be informed of that fact, did you? A. I did not.

Q. Although the relationship was present in your mind and you had an awareness of it at the time that you satisfied SEC regulations by the inclusion of these paragraphs, is that correct? [1195]

A. I was aware of it.

Q. So that you would say that these paragraphs were intended to satisfy SEC regulations, and in addition to that, put the stockholders on inquiry with respect to a transaction had between the corporation and a relative of its chief executive?

A. Yes, sir.

Q. You still cling to that answer, do you?

A. I still cling to that answer.

Q. I see. Is it fair to ask you whether or not you thought it important at that time that the

(Testimony of Stanleigh P. Friedman.)

stockholders be informed of the relationship between the chief executive of Warner Bros. and one of the persons interested in the contract that you were describing?

A. If I had thought it important, I would have suggested that it be incorporated in the notice or in the proxy statement. I did not think it was important.

Q. Did you give it consideration before you came to the conclusion as to whether it was important, in your opinion, or not? A. Yes.

Q. And did you consult with anybody else on that particular phase of it? A. Yes.

Q. And after consultation with some other persons, you [1196] concluded it was the concensus, or was it the unanimous opinion of those with whom you collaborated, that the thing had better not be mentioned?

A. It was the concensus of opinion that it need not be mentioned.

Q. That it need not be mentioned?

A. Correct.

Q. Nobody dissented from that view?

A. No one dissented.

Q. And may I ask now with whom you had these discussions on that particular subject?

A. Mr. Perkins, Mr. Harold Bareford, Mr. Edward Hessberg.

Q. Mr. Carlisle?

A. Well, he may have been consulted on other

(Testimony of Stanleigh P. Friedman.)

terms, other provisions of the proxy statement, or Mr. Martin who works with him.

Q. Mr. Catchings? A. No.

Q. Mr. Guggenheimer? A. No.

* * * * * [1197]

Q. Did you oversee, in any way, or did you do any act, or were you consulted in any way, with respect to the [1229] performance by the parties to that contract?

A. Only with respect to the extensions when they were brought before the Board of Directors, of which I had knowledge in advance; but the performance of the contract I was not kept advised of.

Q. You are speaking of which contract?

A. The basic agreement as amended.

Q. So that from the time the basic agreement was made, namely, Exhibit 1, down to this very day, you had no knowledge of any kind as to what was done in the performance of it, with the exception of such knowledge as came to you when the subject of its amendment was presented to the Board of Directors?

A. And where it was necessary for banking arrangements to be included—where the amendments were required in connection with banking arrangements, then I would know what the figures were, to some extent; but in the course of the years from 1945 to 1953 I had no direct connection with performance of the contract.

Q. May I ask you, Mr. Friedman, at whose instance were you elected a director of Warner Bros.?

(Testimony of Stanleigh P. Friedman.)

A. I was elected, I think, on the nomination of the Messrs. Warner. I was elected by the Board of Directors to fill a vacancy in 1930.

Q. Just prior to 1945, prior to September 28, 1945, [1230] at whose instance were you re-elected a member of the Board of Directors?

A. The Board of Directors names a slate and I was named by the Board of Directors.

Q. Who in the Board of Directors does the naming of the slate originally? Who originally composes the slate?

A. The presiding officer asks, "Are there any recommendations for change in the Board of Directors?"

Q. Whom does he ask?

A. He asks the Board of Directors.

Q. He doesn't ask that of Mr. Harry Warner?

A. If Mr. Harry Warner is the presiding officer, he would do that; or if Mr. Albert Warner is the presiding officer, he would do that.

* * * * * [1231]

Q. Let me ask you this question pointblank: Is it generally Mr. Harry Warner who is asked if he wishes to make any changes in the personnel of the Board?

A. Never in my presence.

Q. Let me ask you this question pointblank: Does Mr. Harry Warner, in effect, control the naming of the Board of Directors?

A. My statement is, unequivocally, "No."

Q. Have you read Mr. Carlisle's deposition?

A. Yes.

(Testimony of Stanleigh P. Friedman.)

Q. I direct your attention to what Mr. Carlisle said in his deposition.

Mr. Williams: I object to the witness being called upon to comment on the testimony of another witness.

Mr. Levy: I am not calling upon the witness to comment upon the testimony of another witness. I haven't finished my question.

The Court: The objection is overruled. Complete your [1232] question.

Q. (By Mr. Levy): Mr. Carlisle was asked as follows:—

The Court: You are reading from where?

Mr. Levy: I am reading from Exhibit 113 in evidence.

The Court: Page and line?

Mr. Levy: Page 45, line—I am afraid I cannot answer that question without counting the lines, because there are no numerals in the margin.

The Court: Toward the foot of the page?

Mr. Levy: Toward the foot of the page.

The Court: Very well; you may proceed.

Mr. Levy: This question was asked of Mr. Carlisle:

“Q. At whose instance were you elected a director of this company, Mr. Carlisle?

“A. Mr. Warner.

“Q. Which Warner? A. H.M.

“Q. I take it that as annual election of directors takes place, the directors are nominated by a group, a committee?

(Testimony of Stanleigh P. Friedman.)

“A. It is generally Mr. Warner there that is asked if he wishes to make any changes.

“Q. And he in effect controls the naming of the Board of Directors, does he not?

“A. That is those inside the organization. [1233]

“Q. Yes. And are you mindful of that?

“A. Yes.

“Q. Mr. Warner and his two brothers in effect control, do they not, whether or not you shall stay on as controller or assistant treasurer of the company? A. Certainly.”

Q. I ask you, Mr. Friedman, does Mr. Warner and his two brothers in effect control whether or not you shall stay on as an attorney for Warner Bros. Pictures, Inc.?

Mr. Williams: Just a moment, before you answer that question. I have no objection to the question whatsoever, but I object definitely to the including of the reading of the testimony of another witness in the matter as making it argumentative in form and asking by implication for an improper comment on the veracity or correctness of the testimony of another witness.

The Court: It is preliminary to the asking of the question, I take it. It is not a part of the question.

Mr. Williams: If it is understood it is not a part of the question, I move to strike that part as being a voluntary statement by counsel which has no place in the record. [1234]

The Court: Do you resist the motion to strike?

(Testimony of Stanleigh P. Friedman.)

Mr. Levy: No. It is in evidence anyhow.

The Court: Granted. Do you mean to ask, Counsel, for his understanding?

Mr. Levy: Yes, your Honor.

The Court: Do you have the question in mind?

The Witness: I haven't the question in mind.

Mr. Levy: I shall ask the question again.

The Witness: Whether the three Warner brothers control my continuance in office as an attorney?

Q. Whether the three Warner brothers control the employment by Warner Bros. of you, yes, Mr. Friedman. A. As an attorney?

Q. As an attorney, yes.

A. The three Warner brothers own about 15 per cent of the stock of the corporation, but if I became persona non grata to any of the Warners or to any other executive, I could not continue as an attorney, and would certainly feel that my presence was no longer required or requested, and I would resign as an attorney.

Q. That is because they are holders of 15 per cent of the stock?

A. That is not the reason; but they are the chief executive officers of the company.

Q. But you said something about 15 per cent of the [1235] stock.

A. I said they own about 15 per cent of the stock, and if you consider that control, I don't want to quibble with you on the word "control."

Q. How do you consider it?

A. I don't consider it control.

(Testimony of Stanleigh P. Friedman.)

Q. You don't consider it working control either?

A. I don't consider it working control either.

Q. Do you consider it as having considerable influence on the affairs of the corporation?

A. I would say it was quite a nucleus by which to obtain additional stock by proxy.

Q. And that is the extent to which you think the Warner brothers had an advantage over any other stockholder in the situation?

A. Absolutely.

Q. Only by virtue of the fact that 15 per cent of the stock ownership was a nucleus from which it could thereafter proceed to gather together the rest of the stockholders to act in accordance with what they conceive to be the thing to do?

The Court: "It could"?

Mr. Levy: They—whether the ownership or control of 15 per cent of the stock——

The Court: The question now is whether the witness [1236] understands it.

The Witness: I understand it, and I would like to answer it.

The Court: Very well.

The Witness: The Messrs. Warner have been the executive officers of this corporation from its inception. They have brought the corporation through thick and thin, financial difficulties of all kinds——

Q. (By Mr. Levy): May I interrupt?

A. Please let me continue. I am entitled to answer your question, and the fact that they have done so well for the corporation, coupled with the fact

(Testimony of Stanleigh P. Friedman.)

that they own 15 per cent of the control would indeed be a nucleus from which they could get huge stockholder proxies for re-election of directors.

Q. But you concede now, do you, or, if you don't, please say so, that for whatever the reason is, the Warner brothers had control of this company?

A. They had 15 per cent of the stock of the company.

Q. And that they controlled the operation of the company, did they not?

A. I think that their opinions would be very much valued, but to say that they controlled the operations of this company simply by virtue of the fact that they own 15 per cent of the stock is not accurate. [1237]

Q. In your judgment, Mr. Friedman, did they control the over-all policies or the basic policies of this company, in your opinion?

A. I think they did, but not by virtue of the fact that they own 15 per cent——

Q. Irrespective——

Mr. Williams: Just a moment. May the witness be allowed to finish his answer?

The Witness: May I finish?

The Court: Yes, finish your answer.

The Witness: I said I think they would, but not by virtue of the fact that they own 15 per cent of the stock of the corporation.

Q. (By Mr. Levy): But by virtue of what?

A. By virtue of their past history and the suc-

(Testimony of Stanleigh P. Friedman.)

cess with which they have managed the corporation from its inception right down to this date.

Q. But, nevertheless, you concede that they controlled the policies of this corporation?

Mr. Williams: Just a moment. That question is objected to as having been asked and answered; and on the further ground it is argumentative in form.

The Court: Sustained.

Q. (By Mr. Levy): Mr. Friedman, before the Board of Directors acted on the contract, on the basic agreement, [1238] Exhibit 1 in evidence, at the meeting of September 28, 1945, did Major Albert Warner in substance convey to the directors present that the agreement was a good one for Warner Bros. and a beneficial one for Warner Bros.?

A. He gave it as his opinion that it was to the advantage of Warner Bros. Inc.

Q. Would you say that he recommended its adoption?

A. I would say that he recommended its adoption.

Q. Would you say that in what he said he conveyed to the Directors present that Harry, Jack and Albert Warner would like to see the Board adopt this resolution?

A. I don't think that is a fair statement. I don't think that he said they would like it adopted. They wanted it submitted to the Board of Directors for their consideration, and the approval was recommended by Mr. Albert Warner.

(Testimony of Stanleigh P. Friedman.)

Q. You are narrating what happened, but what I am asking you is this—you were present: I ask you whether from what you heard Mr. Albert Warner say, did he convey to you, as an individual, now, the impression, did you carry away the thought, in other words, were you made aware, were you conscious of the fact that Harry, Jack and Albert Warner would like to see the Board adopt this resolution? A. I carried away the thought——

Q. Yes or no. [1239]

A. I can't answer yes or no.

The Court: Counsel, you are master of the question but the witness is master of the answer. He is under oath.

Mr. Levy: I thought it was a categorical question.

The Witness: May I have the question?

(Question read.) [1240]

The Witness: May I have the question, Mr. Reporter?

(Question read by the reporter.)

A. I carried away the thought that they recommended this deal as beneficial to the corporation but wanted to submit it to the board of directors for their consideration.

Q. (By Mr. Levy): The fact that a son-in-law of the chief executive of the corporation was involved, and directly and indirectly in the issue before you, did that play a part in the ultimate impression that you carried away with you from the words of Mr. Albert Warner?

(Testimony of Stanleigh P. Friedman.)

A. I think it enhanced the value of the contract to Warner Bros. Pictures, Inc.

Q. In other words, it struck you as the more favorable because of that circumstance?

A. Correct. [1241]

* * * * *

Q. Did you have anything to do, directly or indirectly, with the amendment to the master contract which was made with respect to this Hemisphere business on December 9, 1947?

The Court: Exhibit?

Mr. Levy: Exhibit 5 in evidence. [1243]

* * * * *

Q. (By Mr. Levy): Did you participate either in the drawing of that agreement——

A. No.

Q. ——or in any of the negotiations——

A. No.

Q. ——that entered into it? A. No.

Q. This was out of your ambit entirely?

A. At that time it was, yes.

Q. Are you familiar with the transaction that is involved there?

A. I am aware of it. I am not familiar with it.

Q. You can contribute no information to this court with respect to any part of it, in your opinion? A. Regretfully, no.

Q. I see. You are aware, are you not, Mr. Friedman, that the December 6, 1947 amendment to the master contract which is Exhibit 4 in evidence was not presented to the board of directors of Warner

(Testimony of Stanleigh P. Friedman.)

Bros. for approval or disapproval at all? Are you aware of that fact?

A. I am aware of it, yes. [1244]

* * * * *

Q. Mr. Friedman, I did not ask you why it was not presented to the board of directors. I merely asked you when you first became aware that there was such a thing as Exhibit 4.

A. When I got back from my holiday about the 15th of January in 1948.

Q. Then you found certain memoranda on your desk which indicated——

A. I had a copy of the letter of transmittal to the [1245] trust department with the terms, the highlights of the amendment.

* * * * *

Q. Were you aware of the fact that on March the 3rd, 1947 Mr. Harry Warner had guaranteed a promissory note of United States Pictures to the extent of \$150,000?

A. I don't—I can't say that I was aware of it at the time. It is hard for me to relate that knowledge to any particular time. I knew of the fact that Mr. Warner had guaranteed, endorsed a note of United States Pictures, but I can't relate that knowledge to any particular time.

Q. Is your recollection sufficiently active on that subject that you can say with some reasonable certainty how long after you came back from your vacation and found these documents on your desk did you ascertain the fact that Mr. Harry War-

(Testimony of Stanleigh P. Friedman.)

ner had guaranteed, had individually guaranteed an obligation of United States Pictures to the tune of [1246] \$150,000?

A. I didn't. If I may correct you, please, I didn't find the documents. I found a copy of the letter of transmittal.

Q. Yes.

A. Of December 26, 1947. And I am about to answer your question directly by saying I do not believe I had knowledge at that time that Mr. Warner, Mr. Harry Warner had guaranteed the loan.

Q. I see.

A. But it would be impossible for me to relate the time of my knowledge to any specific period.

Q. But at any rate, you are specific and certain on this subject, that on December 6, 1947 you did not know that Harry Warner had theretofore, on March 3, 1947, guaranteed such an obligation?

A. I don't think I did, Mr. Levy.

Q. Having received that letter of transmittal which indicated that that amendment had gone through the various departments of Warner Bros., among which was the trust department, you did not call a meeting of the directors of Warner Bros., did you, to approve that particular transaction?

A. No, I did not.

Q. Although it had already been set in motion?

A. I did not. [1247]

Q. Can you explain why you did not?

A. I tried to explain before.

(Testimony of Stanleigh P. Friedman.)

Q. Maybe the explanation was lost on me. I am sorry.

A. When I saw the letter of transmittal, the copy of the letter of transmittal, a copy of which was directed to Mr. Carlisle and Mr. Schneider, it just passed away and I didn't think enough of it to bring it before the next meeting of the board of directors.

Mr. Levy: May I have Exhibit 4, please?

Q. You read the letter, though, didn't you, carefully?

A. My letter I read.

Q. Did you read Exhibit 4, that amendment?

A. No. No, I didn't.

Q. Did you get it?

A. I didn't get it, no. I only had a copy of the letter of transmittal.

Q. Oh, I see. So that, in other words, what you got was a document that called your attention to the fact that such an amendment had been executed?

A. That is right.

Q. But contents of the amendment were not made known to you, is that correct?

A. Three or four high spots of the amendment, the change in the terms, the extension, and the change in the overhead and the distribution of profits. I think there were [1248] three or four.

Q. Were called to your attention?

A. Points that were called to the attention of the addresses of the letter.

Q. Might I ask you this, Mr. Friedman, to the best of your recollection was the following called

(Testimony of Stanleigh P. Friedman.)

to your attention: —and this is a letter addressed by Warner Bros. to United States Pictures, Warner Bros. saying the following to United States Pictures:

‘You agree that, prior to the commencement of the principal photography of any of the photoplays hereinbefore referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay, as hereinbefore referred to.’

Do you recall whether the letter of transmittal advised you of the fact that that was part of the amendment that had been executed?

A. I couldn't say for sure, but I think it did.

Q. You think it did. Did that make any impression on you, if it did? A. No.

Q. Did you know what was meant by those words? A. Yes. [1249]

* * * * *

Q. No. I am talking of the time that you got the letter of transmittal. Did you regard this as an important change in the relationship between Warner Bros. and United States Pictures?

A. I regarded it sufficiently as putting me on notice to examine the document and I obtained the document from the trust department. [1252]

* * * * *

Q. Now we are down to, let us say, about February of 1947, aren't we? A. '48.

(Testimony of Stanleigh P. Friedman.)

Q. '48. I beg pardon. '48, when you examined this Exhibit 4? A. That is right.

Q. Now, tell me, Mr. Friedman, is there any explanation for not having called a board of directors meeting after you examined it?

A. I gave it to you.

Q. And it was?

A. That it slipped my attention. I don't know that I was the one charged with bringing it before the board, but at any date, it slipped my attention. I didn't arrange to have it brought before the board at the next meeting. I don't know when the next meeting took place, but I didn't arrange it.

Q. Was it ever brought before the board?

A. Yes, it was.

Q. When? A. In 1950.

Q. Three years later, is that right?

A. Two years later.

Q. Well, December 6, 1947 to July 21, 1950?

A. It was received by me on January 18th or January [1253] 28th, somewhere like that, in '48, and the next meeting of the board of directors was on July 17—I beg your pardon. The next time it was brought before the board was July 12, 1950.

* * * * *

The Court: The second amendment you refer to, is that Exhibit 7 here in evidence?

Mr. Levy: Yes, your Honor.

Q. For the first time then did the board have before it the question of the amendment to the master contract which had already been in opera-

(Testimony of Stanleigh P. Friedman.)

tion for some three years, two and one-half years, is that correct?

A. I haven't any knowledge of that matter being [1254] brought before the board of directors or any individual director before that time.

Q. Yes. Now, on August the 17th, 1950 the board of directors of Warner Bros. met once again to consider what to do with another amendment which was proposed, is that right?

A. An amendment to extend the time to make three additional pictures.

Mr. Levy: That is number what?

Mr. Williams: Exhibit No. 7.

Mr. Levy: Exhibit No. 7.

The Court: Apparently Exhibit 23 is the minutes of a special meeting of the board of directors of August 17, 1950. Is that what you refer to?

Mr. Levy: Yes, your Honor.

The Court: Do you have Exhibit 23, Mr. Clerk?

The Clerk: Yes, your Honor.

Q. (By Mr. Levy): Mr. Friedman, on the 17th of August, 1950 the board of directors of Warner Bros. met and the following people were present: Albert Warner, Waddill Catchings, S. Carlisle, S. P. Friedman, C. S. Guggenheimer, R. W. Perkins and Samuel Schneider and Morris Wolf. I say they were present. I am reading from Exhibit 23 which so indicates.

A. You are not reading from the waiver of notice, are [1255] you?

A. No, I am not reading from the waiver of

(Testimony of Stanleigh P. Friedman.)

notice. I am reading from the secretary's certification, namely, that a special meeting of the board of directors was held that afternoon of that day and there were present the following people. I ask you, Mr. Friedman, when you walked into that board of directors' meeting on that day were you aware of the fact that Cloak and Dagger had been produced, Pursued had been produced, and My Girl Tisa had been produced?

A. I believe so.

Q. Were you aware of the fact that Cloak and Dagger was a profitable picture, that Pursued was a profitable picture, namely, that there was a profit in it for both Warner Bros. Pictures and United States Pictures which they had divided?

A. I believe I knew that.

Q. Were you similarly aware of the fact that My Girl Tisa had been an unprofitable picture?

A. I was aware of that.

Q. Were you aware of the fact that the picture My Girl Tisa had cost in the neighborhood of a little less than \$2,000,000 to produce and that it had grossed in the neighborhood of \$600,000 or \$700,000 all together? Were you aware of that fact?

A. I don't think so. I don't think I was aware of the [1256] figures.

Q. Were you aware of the fact that it was an expensive picture to produce? A. No, no.

Q. Were you aware of the fact that the grosses on it were extremely disappointing?

A. I was not aware of that.

(Testimony of Stanleigh P. Friedman.)

Q. But you were aware of the fact that the picture had caused a loss to the people who were interested?

A. I was not aware that it had caused a loss, but I was aware of the fact that it was not a successful picture.

Q. And that is as far as your knowledge went?

A. That is as far as I had any knowledge or that was brought to the attention of the directors.

* * * * * [1257]

Q. Mr. Friedman, let me put it this way: Let us assume that somebody got up in that meeting of August 17, 1950 and notified you to the following effect: Mr. Friedman, My Girl Tisa has resulted in a loss of \$1,200,000; Warner appears to have lost approximately \$800,000 and some [1264] odd as the result of the production of that picture. If United States Pictures does not produce a successful picture in its fourth venture, namely, a picture which would produce profits so that Warner can recoup out of the fourth picture, the loss that it sustained on the third picture, namely, My Girl Tisa, Warner would be in the position where it would have to look to the fifth picture, if possible, to recoup its loss sustained on the third picture; and if it did not recoup it on the fifth picture, it would have to recoup it out of the sixth picture if it was there to recoup from on the sixth picture; and if after the sixth picture had been produced and Warner had not recouped its \$800,000 loss, then United States Pictures would be obligated to

(Testimony of Stanleigh P. Friedman.)

pay Warner that \$800,000 four years from the first general release of the last picture produced by United States Pictures?

A. Is that a question? Is that a question to me?

Q. If someone had told you that?

A. Is that a question to me or argument?

A. No, no. I am directing a question to you. If somebody had gotten up and made that statement to you at that time and informed you gentlemen on the board of directors that that was the fact, would you have taken that into consideration?

A. Nobody did.

Q. Nobody told you? [1265]

A. Nobody told us that. Nobody raised that question. You are calling upon me to speculate whether my brother would have liked green cheese, and I say I have no brother.

Q. That may be right, Mr. Friedman. Are you aware of the fact, Mr. Friedman, that on August 12, 1952 a further extension of time was granted by Warner Bros. to United States Pictures? A. I am aware of that.

Q. Of the performance of the terms of the basic agreement?

A. I am aware of the existence of the contract you have just referred to, August 12, 1952 I believe it is.

Q. Was there a meeting of the board of directors that preceded or succeeded the signing of that extension? A. I don't recall.

(Testimony of Stanleigh P. Friedman.)

The Court: That is Exhibit?

Mr. Levy: Schedule H attached to the Plaintiff's Exhibit 107 in evidence.

Q. Do you not recall whether there was a meeting or not?

A. I don't recall whether there was a meeting or not.

Q. So far as you know, that agreement was just signed by Mr. Obringer without any authority from the board of directors?

A. I don't know, Mr. Levy. If I did, I would tell [1266] you. [1267]

* * * * *

Q. (By Mr. Levy): Do I understand correctly, Mr. Friedman, that after Mr. Freston had prepared Exhibit 1, you authored an addition to it or a change in it? A. I so testified. [1270]

Q. And it was you who inserted the clause that Exhibit 1 in effect shall not become operative until November 7, 1945?

A. I drafted that clause.

* * * * *

Q. (By Mr. Levy): Was there any relation between the payment to Mr. Bernhard of his salary up to November 7 and the inclusion of that particular clause by you into that contract?

A. No—I just included it because Mr. Bernhard [1271] requested that this contract become operative at that future time, and it might have been in his mind that he was going to draw the

(Testimony of Stanleigh P. Friedman.)

\$3,000 a week until that time, but I had no awareness of that.

Q. Who requested you to insert that clause in that contract?

A. My recollection is that Mr. Bernhard did.

* * * * *

Q. To the best of your recollection, when did you have that conversation with Mr. Bernhard?

A. A week or two before the date of Exhibit 1.

Q. A week or two before September 28, 1945, at which time the Board of Directors approved the contract?

A. Yes. [1272]

Q. In other words, you had had a contract in your possession for a week or two prior to the meeting of September 28?

A. I believe so.

* * * * *

Q. Coming back to the meeting of September 25, 1945, the meeting of the Board of Directors, Mr. Bernhard prior to that time had already told you he wanted you to include this November 7 clause in the contract?

A. Prior to the meeting, yes.

Q. Prior to the meeting at which the Board voted him \$78,000 severance pay; is that correct?

A. Yes, that is correct. * * * * * [1273]

Q. I believe you testified you had known Milton Sperling since 1932. Did you say that, or did Mr. Freston say that? I have forgotten.

A. I was at his wedding.

(Testimony of Stanleigh P. Friedman.)

Q. You were at his wedding. That was in 1939, wasn't it?

A. I think so. I have forgotten when. Whenever his wedding was, I was there. [1275]

* * * * *

SAMUEL SCHNEIDER

called as a witness on behalf of the defendants, having been first duly sworn, testified as follows:

* * * * *

Direct Examination

Q. (By Mr. Williams): Mr. Schneider, you are employed by Warner Bros. Pictures, Inc.?

A. I am.

Q. How long have you been in the employ of that company? A. 30 years.

Q. What is your present capacity with the Company?

A. I am a vice president. I am a director.

Q. How long have you been a vice president?

A. Since 1944. [1298]

Q. How long have you been a director?

A. Since 1944.

Q. Prior to that time, what were your positions in the Company, beginning with when you first started there?

A. I started in the accounting department, and I have gradually worked in practically all of the departments of the Company, and at present I would designate my position as assistant to the president.

Q. Are you active in all phases of the business

(Testimony of Samuel Schneider.)

of Warner Bros. Pictures, Inc. and its subsidiary companies? A. I am.

Q. Which includes matters of production, distribution, and, when they had theatres, exhibition?

A. Yes.

Q. You had your offices in New York City, I take it? A. Yes.

Q. In addition to the work you do at New York, do you from time to time go to other places in the country in connection with the business of Warner Bros. Pictures, Inc.? A. I do.

Q. To what places?

A. I make periodic trips to the West Coast Studios, I would say about two times a year. I have made trips throughout the country to our distribution branches. I [1299] have made many trips to the foreign countries.

Q. All in connection with the business of Warner Bros.? A. Yes.

Q. In your functions, do you keep in touch with Harry M. Warner, Jack Warner, Mr. Perkins, Mr. Carlisle, Mr. Friedman, Mr. Blumenstock, and Mr. Kalmenson, and the other department heads of Warner Bros. Pictures, Inc. and its subsidiaries? A. Yes, I do.

Q. Mr. Harry M. Warner is normally on the Coast? A. Yes.

Q. And has been for a number of years past?

A. Yes.

Q. What is your method of communication with him?

(Testimony of Samuel Schneider.)

A. We constantly talk on the phone. During my trips to the Coast I am practically fifty per cent of my time with him, and during his trips to New York we are constantly discussing business matters.

Q. How about your relations with J. L. Warner?
A. The same.

Q. In other words, your communication with him on production matters is by telephone, and also you meet him personally on the Coast, or if he happens to be back East?
A. Yes.

Q. Is that true of the contact with other heads of [1300] Warner Bros. and its subsidiaries?

A. Yes.

Q. In the practice of the Company on matters involving large sums of money and other matters of importance to the Company, when they come up, is there a practice with reference to the discussion of the various features of those matters among the executive officers of the Company?

A. Yes. Any important matter in our company is discussed between the Warners, myself, and the heads of the departments.

Q. Do you have in mind the contract which has been marked in evidence in this case as Exhibit 1, which is the contract dated the 28th of September, 1945, between Warner Bros. and United States Pictures?
A. Yes.

Q. Are you familiar with that contract?

A. I am.

Q. When did you first learn of the fact that a

(Testimony of Samuel Schneider.)

deal of some sort involving Milton Sperling was in contemplation?

A. I would say at least a year before the signing of the contract. During my trips to the Coast and during Mr. Warner's visits in the East, we discussed the possibility of Milton Sperling being connected with our Company. [1301]

Q. What was the substance of what was said by Mr. Warner and of what was said by you on that subject?

Mr. Levy: May we have some expression from the witness as to the time that he is referring to?

Mr. Williams: I will do that, your Honor.

Q. You said that you first learned of this, or this matter first came to your attention about a year before the contract was signed. How many conversations, as nearly as you can remember, did you have on that subject with Mr. H. M. Warner?

Mr. Levy: May I ask which subject counsel is referring to?

Mr. Williams: The subject we are talking about.

Mr. Levy: May the subject be described a little more definitely?

The Court: You are referring to Exhibit 1?

Mr. Williams: I was referring to the matter of Milton Sperling becoming associated in some manner with Warner Bros., which is the subject I directed the witness' attention to in the previous question.

The Witness: I would say a half a dozen times.

Q. Were those times during the interim between

(Testimony of Samuel Schneider.)

the year before September 28, 1945, and that date?

A. Yes; approximately.

Q. Can you any more closely remember or state at the [1302] present time the date or time of any one or more of those conversations?

A. I know that I visited the Coast at least twice during that year, as I do every other year, and I know Mr. Warner was in New York, and we had long discussions about Milton Sperling as we do about other important matters.

Mr. Warner asked my opinion as to Milton Sperling becoming associated with our company, and in what capacity, and how would he fit into our business; and I gave him my opinion.

Q. What did he say in those conversations and what did you say in those conversations? Be a little more specific, or as specific as your memory will permit.

I want as much of the conversations as you can remember.

Mr. Levy: May it please the court, may we have an expression from the witness as to when this first conversation occurred, or is he about to refer to all of the conversations; in other words, the substance? Is he going to give us the substance of all of his conversations in his one answer, or is he going to give the substance of the first conversation and progressively go on until it comes to the sixth or seventh?

I object to the form of the question on the ground [1303] that the answer will not be suffi-

(Testimony of Samuel Schneider.)

ciently informative of the facts that we are seeking to be brought out. [1304]

Mr. Williams: It will be our misfortune, I suspect, your Honor. I thought I was making it clear that the witness was to answer as to the substance of all these conversations that were being had during that period of time preceding in connection with this contract. If I was not sufficiently clear, I will now ask him.

Q. Are you able to differentiate or state as between these various conversations what was said at one of them and what was said at another?

A. I couldn't possibly say at what date I had a conversation. I can only refer to the visits that I made to the coast and Mr. Warner's visit to the East, during which time we discussed Milton Sperling as well as other matters.

The Court: Are you able to relate the substance of the conversations in the chronological order in which they occurred?

The Witness: I might.

The Court: I take it we are at the first conversation.

Mr. Williams: Yes.

Q. Can you remember what was said the first time you talked with Mr. H. M. Warner on that subject?

A. Without remembering a date, the first conversation with Mr. Warner was: What do I think of Milton Sperling becoming connected with our company in a production capacity? [1305] And in

(Testimony of Samuel Schneider.)

our business the most important thing in our business is production of motion pictures. We are constantly discussing that subject, as we are discussing the subject today.

When Mr. Warner spoke to me about Milton Sperling, I knew prior to his conversations about Mr. Sperling what his business had been, what his experience had been, what pictures he had produced, what work he did at other companies.

After discussing the matter with Mr. Warner I discussed the matter with other executives in our company so I can form a better opinion as to how Mr. Sperling would fit into our company.

Q. Did you answer Mr. Warner at once when he asked you what you thought of having Milton Sperling come in in a productive capacity or production capacity? Did you answer him at once, or did you answer him later?

A. At the beginning we had a general discussion and——

Q. What I am trying to get at is: What did Mr. Warner say to you and what did you say to him?

A. The substance of the conversation was: What do I think of Milton Sperling becoming connected with our company in a production capacity. My answer was, and it would be the same with any other person that he would suggest, and that is that if the person has the ability and the company can work out the proper deal, that it might be the right thing for our company. [1306]

(Testimony of Samuel Schneider.)

And subsequent to that I discussed the matter with other executives of our company, as we usually do in our business, and in subsequent conversations with Mr. Warner and other executives we developed the idea of Mr. Milton Sperling becoming connected with our company in a production capacity.

Q. After you first talked with Mr. Warner with what other executives of the company did you discuss the matter of Mr. Sperling becoming associated in a production capacity?

A. The most important two people that I discussed a matter of this kind would be Jack Warner and our salesmanager, Mr. Kalmenson. And I had many conversations with those two individuals on this matter.

Q. Have you given us the substance of the first conversation you had with Mr. H. M. Warner?

A. Yes.

Q. Can you remember the next time you talked with him on the subject?

A. I couldn't fix any dates, as I said.

Q. I understand that, but can you remember the fact of your having a second conversation on the subject?

A. Yes. I had many conversations and, as I said, they were during my visits to the Coast, during his visits to New York, and on the telephone. And in subsequent conversations we went more deeply into the matter as to how he could be connected with our company, in what capacity. [1307]

(Testimony of Samuel Schneider.)

Q. What was said by Mr. Warner and what was said by you on that subject?

A. Well, I could best summarize Mr. Warner's conversations to me by saying that he suggested that Milton Sperling be connected with our company in a production capacity. At the beginning there were no details as to what capacity that might be, and we discussed the possibility of him coming in as a producer or as assistant to Jack Warner, or in some sort of a setup, as we have in our business, of a producing unit producing pictures which would be distributed through our company. And, as I discussed the matter with other executives in our company, Mr. Jack Warner, Mr. Kalmenson and others, as we went along we developed the plan until it was finally finalized into the form that we made the agreement.

Q. During those conversations did you talk with Milton Sperling about the subject at all?

A. Oh, yes.

Q. When did you first talk to Milton Sperling about it?

A. Well, I could not fix the date but it was sometime prior to the signing of this contract I had a few conversations with him.

Q. Then do you remember about how long it was before the contract was signed?

A. No, I couldn't.

Q. I will ask you this: At the time the contract came up before the Board of Directors for action you were in New York, were you? [1308]

(Testimony of Samuel Schneider.)

A. No.

Q. Were you at that time on the Coast?

A. Yes.

Q. And had you been on the Coast for some time then? A. About two weeks, I would say.

Q. During——

Mr. Levy: Pardon me. May we have the record clear on the subject? He said "at the time the matter came on for action by the board of directors." You refer to September 28, 1945?

Mr. Williams: Yes.

Q. You so understood, did you, that I was talking about September 28, 1945, when the board acted on this contract?

A. I was not in New York on the day that the contract was approved by the board.

Q. Yes.

A. I know that because I looked it up.

Q. Mr. Schneider, you say you had been on the Coast, by which I suppose you mean you had been at the offices of the company out in Burbank and out here generally in connection with the business of the company for about two weeks prior to that date, September the 28th? A. Yes.

Q. During that time had you seen Milton Sperling and [1309] talked with him about the matter?

A. I couldn't remember.

Q. You have spoken of having talked with Mr. H. M. Warner and how this subject was developed. Do you know who first suggested, as far as your knowledge goes, who first suggested that the matter

(Testimony of Samuel Schneider.)

of having Milton Sperling connected with the company should be in the form of a separate producing company or separate producing organization to make pictures for Warner's distribution?

A. To the best of my recollection, that was a result of a number of conversations between various people. I couldn't recollect who made the suggestion, specifically.

Q. What persons do you refer to when you say conversations among various people?

A. Harry Warner, Jack Warner, Albert Warner, myself, Mr. Sperling, Mr. Joe Bernhard.

Q. Do you remember when it was that Mr. Joe Bernhard's name first came into the discussion in connection with this matter of Milton Sperling becoming connected with the Warner organization?

A. Well, during my conversations with Mr. Warner Mr. Bernhard's name was also suggested as a possible man to—well, Mr. Bernhard's name was suggested at the time that it was decided that a unit would be set up.

Q. And it was Mr. H. M. Warner who first mentioned Mr. [1310] Bernhard's name to you, was it?

A. I would imagine that it was.

Q. Did you talk with Mr. Bernhard on that subject? A. Yes.

Q. And how many talks did you have with him?

A. I had a few talks with him in New York.

Q. What was the substance of what you and he said to each other on the subject?

A. Well, Mr. Bernhard and myself, we worked

(Testimony of Samuel Schneider.)

closely together, and he discussed with me the possibilities of being connected with a unit to produce pictures at our studios. He asked my opinion of it. He asked what I thought would be the possibilities of such a unit in the future. I gave him my opinion. I told him.

Q. What did you tell him?

A. I told him that the most important function in our company is the making of motion pictures; that, from my experience, the people, business people who had experience in running theatres, such as Mr. Bernhard had, and an all-around experience as to the public's taste for pictures would be a very important adjunct to a production unit. I base that on the knowledge that in other companies, specifically Paramount, that—

Mr. Levy: May I interrupt at this time? I think the witness is going beyond the purview of the question and [1311] what he is about to testify appears very plainly to be not responsive to the question.

Q. (By Mr. Williams): I do not know how much of this you said to Mr. Bernhard or how much you did not, but confine yourself to what you said to Mr. Bernhard on the subject, Mr. Schneider.

A. I told Mr. Bernhard that the most important function in our business was the production of motion pictures. That the knowledge of a man of his caliber and his experience would be very important in a producing unit. And I told him that there was

(Testimony of Samuel Schneider.)

a very good future in an enterprise of that kind and it would be very good for our business.

Q. You have spoken of your discussions with Harry Warner and Jack Warner and Mr. Sperling and Mr. Bernhard. What was the substance of your discussion with Mr. Kalmenson on this subject?

A. I discussed with Mr. Kalmenson, who is our sales manager, the possibility of a man like Milton Sperling being connected with our company, and then the possibility of a producing unit being set up which would produce pictures for our company. And we discussed between ourselves that it would be a good thing for our company because an independent unit is able to attract outside talent. And Mr. Kalmenson is always willing for a unit of that type to be set up, so that we would obtain motion pictures. [1312]

Q. What did he say with reference to this particular matter of a unit involving Joseph Bernhard and Milton Sperling, as to whether he was favorable or unfavorable to that particular setup?

A. Well, he thought like I did, that with Mr. Sperling's ability and Mr. Bernhard's ability, that they could set up a production unit that would attract talent and would make a caliber of picture which would be beneficial for our company.

Q. What was the situation with reference to what number, or the pictures that you had available at that time? In other words, what I am getting at is: Was Warner Bros. in such a condition that

(Testimony of Samuel Schneider.)

it was desirable that you should have more product than you were getting at the time?

Mr. Levy: I object to the question on the ground that it calls for a conclusion. I have no objection to the witness relating the Warner inventory at the time, though I think the question calls for a conclusion.

Mr. Williams: Inventory is meaningless.

The Court: Overruled. You may cross examine him on the conclusion if you are so advised. You may answer. [1313]

The Witness: The condition in a motion picture company such as ours is always at a point where we need product. It is not a question of whether at that time we had a sufficient number of pictures to release that year. It was a question of how will we get the next batch of pictures, and we are constantly seeking producer or production contracts, stars, directors, stories, and we are always in search for mediums to obtain motion pictures.

Q. At that time how many exchange centers or exchanges did Warner Bros. operate in the United States? A. About 35.

Q. How many theatres in the United States were served by those exchanges?

A. Over 400.

Q. I am not talking about Warner theatres; I am talking about theatres as a whole.

A. I would say anywhere from fifteen to eighteen thousand.

(Testimony of Samuel Schneider.)

Mr. Levy: May we have a definition of what "as a whole" means?

Mr. Williams: I mean all theatres in which they show licensed pictures.

Mr. Levy: You mean theatres other than theatres owned by Warner Bros. Pictures?

Mr. Williams: Certainly; that is what I am talking [1314] about.

Q. You understood me, didn't you, that I was talking about theatres in which Warner Bros. licensed pictures? A. Yes.

Q. Including their own theatres? A. Yes.

Q. How many theatres in the United States were owned by Warner Bros. at that time?

A. Over 400.

Q. In foreign countries did Warner Bros. have distribution organizations? A. Yes.

Q. In how many foreign countries, approximately? A. Over 40.

Q. In England or in the United Kingdom, specifically, did Warner have additional distribution organization? Did it have an interest in theatres?

A. Yes; we own 37½ per cent of a circuit of theatres, over 400.

Q. In the United Kingdom? A. Yes.

Q. Did Warner own theatres in any other countries outside of the United States and the United Kingdom?

A. At that time we had a few. [1315]

Q. I am referring always, Mr. Schneider, to before the 2nd of March of this year, before there

(Testimony of Samuel Schneider.)

was a complete disposition of Warner theatres under a decree of the Federal Court. A. Yes.

Q. And this situation, concerning which you have been testifying, is the situation that existed in 1945? A. Yes.

Q. Prior to September 28, 1945, as has been shown here in this case in evidence, Warner Bros. had made several production-distribution contracts with several different organizations.

Were you aware of that fact at that time?

A. Yes.

Q. Were you aware of the fact that they had first made the Cosmopolitan contract back in 1936?

A. Yes.

Q. And later the Capra and the Bette Davis and the other contracts that have been shown in evidence here? A. Yes.

Q. Was it at that time your opinion that the making of production-distribution contracts as a method of obtaining pictures was of advantage to Warner Bros.?

Mr. Levy: May we have an expression from Mr. Williams as to what he means by "at that time," specifically? [1316]

Mr. Williams: The time I have been talking about.

Mr. Levy: Namely?

Mr. Williams: September, 1945.

The Witness: Every contract that we ever went into, we did it with the knowledge, or we did it

(Testimony of Samuel Schneider.)

with the thought that it would be to the benefit of the Company.

Q. (By Mr. Williams): That is not answering my particular question.

My question was: In September, 1945, was it your then opinion that the making of contracts with independent producers, that method of obtaining product for distribution by your company was of advantage to Warner Bros., that type of contract?

A. Yes.

Q. In addition to talking this matter of the proposed agreement over with Sperling and Bernhard, with M. H. Warner and the other persons you have mentioned, did you talk over the matter with Mr. Friedman?

A. Yes.

Q. With Mr. Perkins?

A. I might have.

Q. Did you discuss the matter with Mr. Carlisle?

A. Yes.

Q. Mr. Carlisle is the head of the accounting department, is he not? [1317]

A. Yes; he is the controller.

Q. Do you remember any other persons with whom you discussed the matter?

A. I might have discussed the matter with Mr. Freston. I am not sure, though.

Mr. Levy: May we have some indication of the time that the witness has referred to, when he discussed the matter with Mr. Freston?

Mr. Williams: If the witness can remember.

(Testimony of Samuel Schneider.)

The Witness: Prior to the signing of the contract.

Q. Can you fix it any more definitely than that?

A. No. I might have discussed it with other people of which I am not sure, like Mr. Trilling in our studio, and Mr. Obringer.

Q. Mr. Trilling has what position?

A. He is the assistant to Jack Warner.

Q. And Mr. Obringer?

A. He is in our legal department.

Q. Is it your recollection you did discuss it with those men? A. I wouldn't be sure.

Mr. Levy: When you say "it," was "it" referred to in the question concerning the desirability of having Sperling come into the organization?

Mr. Williams: It refers to what I was asking about, [1318] the deal with Sperling and Bernhard to make pictures.

Mr. Levy: I see.

Q. (By Mr. Williams): Mr. Schneider, did you see the contract that was finally signed, or what purported to be a draft of it, at any time before it was signed, that is, the actual contract itself?

A. I couldn't recall.

Q. What was your understanding at that time as to what the terms of the contract were?

A. I knew——

Mr. Levy: May we have the time again fixed?

Mr. Williams: I just got through saying "at the time of the signing."

(Testimony of Samuel Schneider.)

Mr. Levy: At the time of the signing?

Mr. Williams: Yes; at the time of the signing.

I just got through saying it.

Do I have to keep saying it in every sentence?

Mr. Levy: No; sorry.

The Witness: I was familiar with all the terms, of course, prior to the signing.

Q. (By Mr. Williams): State to the best of your recollection what you now remember the terms were.

Mr. Levy: I move to strike the answer of the witness on the ground it is a conclusion.

Well, I will withdraw the motion. [1319]

Q. (By Mr. Williams): State, as nearly as you can now remember, what you then knew in detail as to what the terms of the contract were.

A. The final terms of the contract, as I remember them, and as I know them now, were that United States Pictures would produce six pictures in a period of three years; Warner Bros. Pictures would put up 50 per cent of the money, United States Pictures would put up 50 per cent of the money; Warner Bros. Pictures would receive 20 per cent for domestic distribution, 25 per cent for distribution in the United Kingdom, and a schedule of distribution charges in the other foreign countries; that Warner Bros. would charge to the cost of production 30 per cent of its production facilities, and 18 per cent of the facilities furnished by United States Pictures; which formula was arrived at by Price, Waterhouse.

(Testimony of Samuel Schneider.)

Warner Bros. Pictures would advance the cost of prints, advertising and other charges.

That when the pictures were distributed, we would deduct our distribution charges and the other charges that I mention.

The next money would be paid toward the United States Pictures' 50 per cent advance for production. The next money we would deduct as our advance for production, and the balance would be divided 50-50. [1320]

Also that United States Pictures would endeavor to obtain stories, personalities, without which they couldn't produce pictures; that we could recoup any losses from subsequent pictures, and in the event there was a loss not recouped, that at the end of four years after the release date of the final picture, United States Pictures would pay us the difference.

Q. Have you now related what you remember as to your then knowledge of the contract?

A. Yes.

Q. Was it your opinion at that time that that contract was favorable to the business interests of Warner Bros.?

A. Yes.

Q. What advantages, if any, are there to a studio like Warner Bros. having an independent producing unit within the studio?

A. The greatest advantage, as we look on it, is that they are able to obtain the services of stars, directors, writers; they are able to obtain stories. Warner Bros. are always in a favorable position

(Testimony of Samuel Schneider.)

with a contract of that type because they absorb part of our overhead. We obtain the distribution charges. We also use other facilities of our organization, such as checking theatres, and our prints which are furnished by [1321] our laboratory, so that we absorb the overhead charges in our laboratory. The use of our music and our music companies, and also the ability to obtain pictures, which we are always trying to get, playing the pictures in our own theatres, which gives us a profit in our theatres. And the all-around benefits of a unit of that type are very large.

Q. Mr. Schneider, since the making of the contract which has been marked Exhibit 1 in this case, have you, yourself, kept track of how the operation of it has worked out? A. Yes.

Q. Have you observed what pictures have been produced and the results generally from those pictures?

A. Yes; that is one of my important functions with the company.

Q. In the performance of that function, you have kept your eye on what has happened as a result of making this contract? A. Yes.

Q. What pictures have been produced?

A. They produced eight pictures and are producing a ninth.

Q. And are producing a ninth? A. Yes.

Q. Do you know, generally, about what the financial [1322] results of the production of those pictures have been? A. Yes.

(Testimony of Samuel Schneider.)

Q. Will you state what they are from the viewpoint of Warner Bros.? A. Yes.

Mr. Levy: The question is objected to on the ground it calls for the conclusion of the witness.

Mr. Williams: No; it is not. It is calling for the knowledge of this man, whose business it is to keep track of these matters.

Mr. Levy: You mean he is to give us his knowledge of this whole transaction in one breath?

Mr. Williams: Yes.

The Court: The objection is overruled. You can cross examine as fully as you wish, if so advised.

You may answer.

The Witness: There were eight pictures produced by United States Pictures. Seven of them have either shown a profit or will show a profit, based on the terms of the contract.

The over-all profit of the seven pictures, I would say, would be about three and a half million.

The loss on the one picture, *My Girl Tisa*, a million two, bring the net profit approximately over two million dollars. [1323]

The Court: Is that the net profit to the corporation, Warner Bros.?

The Witness: No, the net profit of the pictures entirely, about two million dollars. Under the terms of our contract, we would receive about a million and a half dollars of that profit and United States Pictures about half a million dollars.

Besides that, our company will receive between

(Testimony of Samuel Schneider.)

five and a half million and six million dollars in distribution charges.

We will receive over three and a half million overhead charges of the studio.

The profits in our own theatres would be upward of a million dollars.

So that the total benefits to our company, in my opinion, would be in excess of eleven million dollars.

Mr. Levy: May I move the answer of the witness be stricken, if the court please, on the ground it is a conclusion of the witness; is incompetent, irrelevant, and immaterial to establish the fact, namely, the profit that Warner Bros. has made over-all, the profit that Warner Bros. has made as the result of overhead, as the witness expressed it, and the profit Warner Bros. has made as the result of exhibition, as the witness has expressed it; and in every respect in which the witness [1324] used the word "profit."

I respectfully submit his whole answer is a conclusion on the part of the witness, and is not the best evidence in the case.

Mr. Williams: We resist the motion, your Honor.

The Court: Motion denied.

Q. (By Mr. Williams): Mr. Schneider, I direct your attention to the fact that there was an amendment to the United States Pictures contract, the basic agreement, and, incidentally, in questioning you further, in order to save ourselves time and words, when I speak hereafter of the basic agree-

(Testimony of Samuel Schneider.)

ment I will mean the agreement dated September 28, 1945, between United States Pictures and Warner Bros.

The Court: Exhibit 1 here.

Mr. Williams: Exhibit 1 in this case.

Q. Now, are you aware of the fact that there was an amendment dated May 20, 1946, which is marked Exhibit 3 in this case, and which had to do with the Hemisphere Pictures? A. Yes.

Q. Prior to the making of that contract, did you know anything about it? A. I did.

Q. From whom did you first learn of that matter? [1325]

A. From Milton Sperling.

Q. Were you in New York or California, or where?

A. I couldn't remember. I recall I had a long telephone conversation with Mr. Sperling.

Q. What was the substance of the conversation you had with Mr. Sperling on that subject?

A. He told me that there was a possibility of obtaining the story Pursued, written by Niven Busch, starring his wife, Teresa Wright, and he thought that this would be a good picture to make, that Jack Warner thought it was a good property, but in order to obtain that project that he would have to make a deal with them on some sort of a percentage basis.

Q. Did he tell you further what the percentage was or what the details of the basis were?

(Testimony of Samuel Schneider.)

A. Yes; he discussed approximately some of the details.

Q. Tell us, as well as you can remember, what details he gave you.

A. They would want a percentage of the profits, and I don't recall exactly what the details might have been, but I do know what the final deal was after discussions.

Q. We will get to that later. What did you say in response to his statement to you that some sort of a [1326] profit-sharing deal would have to be made?

A. I told him if a deal could be worked out, that we would feel would be beneficial for our company, "By all means make it."

Q. Thereafter, did you have further discussions with him or with any other person about this proposed Hemisphere deal before it was finally consummated? A. Yes.

Q. With whom did you discuss it?

A. I discussed it with Jack Warner, Milton Sperling, and the sales manager.

Q. That is Mr. Kalmenson? A. Yes.

Q. What was the substance of the conversation you had with Mr. Jack Warner on the subject?

A. What did he think of the property Pursued, starring Teresa Wright.

Q. What did he say, is what I am asking you.

A. He thought it was a very good story and could be made into a good picture.

(Testimony of Samuel Schneider.)

Q. The substance of your further conversation with Milton Sperling was what?

A. At the time that he worked out the final details or possible deal——

Q. No; what did he say to you? [1327]

A. He told me the final terms.

Q. What did he tell you?

A. He told me that the profit would have to be split one-third to those people, one-third to United States Pictures, and one-third to Warner Bros.

Mr. Levy: By "those people," does the witness mean Niven Busch and Teresa Wright?

The Witness: Yes.

Q. (By Mr. Williams): What else did he tell you?

A. He told me in endeavoring to work out the terms, they worked out certain terms, and United States Pictures would charge this unit, and whatever the difference would be between what we charged United States Pictures and they charged the other company would be split 50-50 between us.

Mr. Levy: Does the witness mean Hemisphere when he says "the other company"?

Mr. Williams: Of course he does.

Mr. Levy: I just want the record clear.

The Court: Address your remarks to the court, gentlemen, and let us have no more bickering between you.

Mr. Levy: May I ask at this point, in order to clear the record, that the witness, in designating this other person, is speaking of Hemisphere, so

(Testimony of Samuel Schneider.)

we will be clear on the subject? Then I won't have to cross examine on the [1328] subject, if the witness will actually say so-and-so. That is the reason for the interruption.

Q. (By Mr. Williams): Had you completed your answer?

A. He told me that they would charge—

The Court: You see, "they" 'is very indefinite.

The Witness: Yes. Milton Sperling told me that United States Pictures would charge Hemisphere 25 per cent for domestic distribution, 30 per cent in Great Britain, and the same schedule of percentages in the foreign countries as we were charging United States Pictures, and they would charge them a larger amount for the overhead of the studio, which I think was 45 per cent.

Then I proceeded to calculate as to what that would mean to our company, the fact that we would get $22\frac{1}{2}$ per cent domestic and the $27\frac{1}{2}$ per cent in Great Britain and half of the overhead charges between the 30 and 45 per cent, and by a quick calculation I told Milton Sperling that those terms were as satisfactory to Warner Bros. Pictures as if the picture was made by United States Pictures.

Q. (By Mr. Williams): What was the substance of your conversation with Mr. Kalmenson on the subject of this proposed Hemisphere deal?

A. I merely discussed with Mr. Kalmenson the possibility of the company obtaining a picture called *Pursued*, written by Niven Busch and star-

(Testimony of Samuel Schneider.)

ring Teresa Wright, [1329] and he thought it was a good thing to get that picture.

Q. What was the reason you discussed these things with Mr. Kalmenson?

A. Mr. Kalmenson is our sales manager, who is constantly traveling throughout the United States. He knows the pulse of the public, and he is constantly talking with exhibitors, and he is best qualified in our company to pass an opinion as to whether a certain picture, starring certain people, would be good box office.

Q. What was your opinion when the contract was finally presented to the Board of Directors; when the United States Pictures deal was finally presented to the Board of Directors, what was your opinion as to whether or not it was a contract for the benefit of Warner Bros.?

A. Do you mean the——?

Q. The Hemisphere amendment to the basic agreement, and by the Hemisphere amendment I am referring to Exhibit 3 in this case.

A. I thought it was satisfactory.

Q. You were present at the meeting of the Board which approved that contract, were you not, on June 18, 1946?

A. I wouldn't remember.

Q. You don't remember?

A. No. If the records show I was there—but I [1330] couldn't remember.

Q. At any rate, whether you remember being

(Testimony of Samuel Schneider.)

there or not, you personally did approve the contract? A. Yes.

Q. I call your attention to the fact that under date of July 21, 1950, there was another amended or supplemental agreement executed between United States Pictures and Warner Bros. which has been marked in evidence in this case as Exhibit 7.

The Court: Do you wish the document placed in front of the witness?

Mr. Williams: Yes. May the document be placed in front of the witness?

The Witness: I am familiar with the document.

The Clerk: Did you say No. 7, Mr. Williams?

Mr. Williams: I think, if your Honor please, I will withdraw that at this time and go to the December 6 agreement, which is Exhibit 4.

In looking here, I passed up that particular exhibit.

May the witness have placed before him Exhibit 4?

Q. Mr. Schneider, I call your attention to Plaintiff's Exhibit 4 in this case, an agreement in the form of a letter dated December 6, 1947, and which is the agreement which we referred to here yesterday, and one which provides for additional pictures, and extends the [1331] time for the making of original pictures.

Prior to the execution of that agreement, did you have any conversation with any person or persons concerning the matter of deferring the making of further pictures under the basic agreement and the

(Testimony of Samuel Schneider.)

matter of having an arrangement for the making of additional pictures? A. Yes.

Q. With whom did you first discuss that subject?

A. I wouldn't remember who I first discussed it with, but I know I discussed it with Milton Sperling, Jack Warner, Harry Warner, Albert Warner, and our sales manager.

Q. You cannot remember who it was that you first discussed it with? A. No.

Q. Can you tell us what the substance of the conversations you had with Milton Sperling was?

Mr. Levy: May we have the time, your Honor, approximately fixed?

Q. (By Mr. Williams): If you can do so, fix the time, Mr. Schneider.

A. It was prior to the signing of the contract. I couldn't possibly fix the exact time. I would say maybe a few months before.

Q. You did then talk with Milton Sperling?

A. Yes. [1332]

Q. Did you talk with him more than once on the subject? A. Yes.

Q. About how many times did you discuss the matter of this proposed contract with Milton Sperling before the contract was executed?

A. It was more than once.

Q. Can you give us the substance of what was said by Milton Sperling and what was said by you in those conversations?

A. I recall that he asked my opinion as to the

(Testimony of Samuel Schneider.)

advisability of continuing on the basis of the original contract, which called for the borrowing of money at the bank. In view of the falling box office receipts in the theatres, he expressed a reluctance about making the next picture under that method, and borrowing money from the bank. [1333]

Q. What did you say to that?

A. I advised him about the condition of the picture business and told him that box office receipts were falling and that there was a risk in borrowing money from the bank at that moment and making a picture. It was a general conversation between the two.

Q. Was anything said at that time on the subject of making pictures for Warner on a different basis?

A. Yes.

Q. What was said and by whom?

A. Well, specifically, with Milton Sperling. He desired to make pictures and the company wanted him to go ahead and make pictures. He had stories prepared. He had an organization. We wanted pictures and we discussed generally the possibility of making pictures by United States Pictures on a different basis.

Q. Was anything said between you as to what that different basis would be?

A. We discussed generally a possible modification of the contract.

Q. Did you go into any detail as to who would finance the pictures?

A. Well, I couldn't say that it was at the first

(Testimony of Samuel Schneider.)

conversation with Mr. Milton Sperling but after discussing the matter with other people in our organization, I was [1334] prepared and did talk to Milton Sperling about a modification of the contract under another basis.

Q. All right. Now, let's just leave Mr. Sperling for the moment. After you first talked with Mr. Sperling with whom did you discuss the subject of a possible change in the contract?

A. With Jack Warner, with Harry Warner, with Mr. Kalmenson, with Mr. Albert Warner, with Mr. Carlisle.

Q. What was the substance of your conversation or conversations with Harry Warner on that subject?

A. Along the same line and about the——

Q. Just tell us as nearly as you can remember what he said and what you said.

A. About the fact that, with the falling box office receipts, the risk involved in United States Pictures borrowing 50 per cent of the production cost of a picture from a bank at that time, our opinion was at that time that box office receipts would fall more drastically and that the condition of business would be even worse than subsequently the case was. And I discussed with Mr. Harry Warner that we were discussing a different form of a contract.

Q. What did he have to say as to that?

A. Well, he didn't participate in any talk about what terms we could fix. Usually in a case of that

(Testimony of Samuel Schneider.)

kind Mr. Warner relies on the other executives of the company to come [1335] up with terms and conditions of a contract that would be satisfactory to our company.

Mr. Levy: May I move to strike the latter part of the witness' answer?

Mr. Williams: We think it is within the issues, your Honor. The fact it is not responsive to the particular question——

Mr. Levy: It is not responsive. He was asked what he discussed with Mr. Warner, what did Mr. Warner say to him in substance and what did he say to Mr. Warner. I have no objection to the rest of the answer, but the last part of the answer is a departure from the point of the question.

Mr. Williams: We admit that, your Honor, but it is admissible as being relevant to the issues involved.

The Court: It is a statement as to proof.

Mr. Levy: I do not press the objection.

The Court: Motion denied.

Q. (By Mr. Williams): Where were you? Do you remember? A. Yes.

Q. Proceed.

A. In a matter of this kind when there is a discussion between the executives, Harry Warner would leave the terms, the detail of the working out of a contract to his executives.

Q. In this particular case, then, as I take it from your testimony, Mr. Harry Warner did not

(Testimony of Samuel Schneider.)

discuss with you any [1336] of the details of this proposed change? A. I don't think so.

Q. Yes.

A. I might have advised him about the final contract.

Q. With reference to your conversation with Jack Warner, you talked this matter over with him, that is, the matter of a proposed different arrangement for the making of additional pictures?

A. Yes.

Q. What was the substance of the conversation you had with Jack Warner? What did you say and what did he say?

A. I discussed with Jack Warner the point that Milton Sperling raised about the advisability of borrowing money at that time and the advisability of United States Pictures going ahead and making pictures on a different basis. Jack was satisfied to do that if the right deal could be worked out.

Q. And you say you talked it over with Mr. Kalmenson? A. Yes.

Q. What was the substance of your conversation with Mr. Kalmenson?

A. Merely that we were trying to work out a deal with United States Pictures whereby they would continue to produce pictures on a different basis. Mr. Kalmenson would not be interested in the various terms under the contract, other than the fact that they would produce pictures and the distribution [1337] terms.

(Testimony of Samuel Schneider.)

Q. Did you discuss the distribution terms with him? A. Yes.

Q. What did you say to him and what did he say to you with reference to distribution terms under the proposed agreement?

A. I discussed that with Mr. Kalmenson after we had arrived at some sort of a basis.

Q. And what was the substance of that conversation?

A. I advised Mr. Kalmenson that under a new contract we were proposing that the distribution terms domestic would be 25 per cent instead of 20, that the United Kingdom terms would be 30 instead of 25, and that we would receive the various schedule of percentage throughout the world in other countries.

Q. Now, having this——

Mr. Levy: May it please the court the answer of the witness who said: "I advised Mr. Kalmenson" of these facts, namely, the distribution percentages, after we had arrived at the terms, may the witness at this time state, in order to save time on cross examination, whom he meant by "we"?

The Court: Yes.

A. Mr. Sperling, myself, and after having discussed the matter with Jack Warner or Harry Warner.

Mr. Williams: I was going to have that. [1338]

Q. After you had discussed the matter with Harry and Jack Warner and other persons you mentioned did you have a further conversation with

(Testimony of Samuel Schneider.)

Milton Sperling at which a deal was agreed upon?

A. Yes.

Q. Just state the substance of that conversation.

A. We discussed the final terms of a deal, which were that Warner Bros. Pictures would advance 100 per cent of the production cost; that under the new deal it would not be — under the new deal United States Pictures would use more of the facilities of Warner Bros. Pictures' studios; that the overhead charge would be our regular overhead charge which we charge to all pictures; and that the distribution terms would be 25 per cent domestic and 30 per cent in Great Britain and various schedule in other foreign countries; and that we would still advance the cost of prints, advertising and other charges, and the net profits would be divided 80 per cent to Warner Bros. Pictures and 20 per cent to United States Pictures.

And also during the conversation we discussed the fact that we would keep the profits of the additional pictures to recoup any losses on any previous pictures under our original contract.

The Court: We will take the morning recess at this time.

(Short recess.) [1339]

Q. (By Mr. Williams): I don't remember whether you had testified, Mr. Schneider, but do you remember whether you were present at the time that—I withdraw that question.

At the time that you gave your approval to the terms of what became the agreement of December

(Testimony of Samuel Schneider.)

6, 1947, Exhibit 4 in this case, was it your opinion at that time that that was for the benefit of Warner Bros. Pictures, Inc.? A. Yes.

Q. I now call your attention to Exhibit No. 7 in this case. The clerk is handing you the exhibit, which you will observe is an agreement dated July 21, 1950 between United States Pictures and Warner Bros. Prior to the time that that agreement was executed were you aware of the fact that such an agreement was in contemplation and was being discussed? A. Yes.

Q. Did you discuss it with any person or persons? A. Yes.

Q. With whom did you discuss the matter of this proposed agreement?

A. It was practically the same procedure as the previous contract; with Milton Sperling, with Jack Warner. There wasn't too much discussion because it was merely another postponement of the making of the original pictures and the addition of three additional pictures. So the conversations were practically along the same line. [1340]

Q. Do you remember in connection with that talking to Mr. Obringer about it?

A. I might have.

Q. Do you remember whether or not you instructed Mr. Obringer to draw a contract providing for this extension of time and additional pictures?

A. I might have instructed him.

Q. Do you have any recollection of it now as to whether you did or did not?

(Testimony of Samuel Schneider.)

A. No, I don't.

Q. You were, however, aware of the fact that such a contract was to be drawn, and did you approve of it? A. Yes.

Q. Did any of the persons with whom you discussed the matter voice any disapproval of this additional contract Exhibit 7?

A. Not that I recall.

Mr. Levy: Pardon me, may it please the court. May the witness at this time name the persons that are referred to in the previous question?

Q. (By Mr. Williams): Just give the names of the persons to whom you talked about this contract. You have named them once.

A. Mr. Sperling.

Q. Any other person? [1341]

A. Jack Warner, our sales manager, but I couldn't recall specifically whether I spoke to each one that I named in the previous contract.

Q. You do remember these three?

A. Oh, yes.

Q. That is, Mr. Sperling, Jack Warner, and Mr. Kalmenson? A. Yes.

Q. And, as I understand, you don't remember whether you did or did not instruct Mr. Obringer to draw the additional agreement?

A. I don't remember.

Q. At the time that you discussed this matter did you believe that it was a good thing for Warner Bros., it was for the benefit of Warner Bros. that those terms should be additionally extended

(Testimony of Samuel Schneider.)

and provision should be made for the making of additional pictures? A. Yes.

Q. Were you present at the meeting of the board of directors when the contract of July 21, 1950 was presented to the board for approval?

A. I don't remember.

Q. You do not remember whether you were or were not before the board?

A. That is correct. [1342]

Q. But whether you remember being before the Board or not, you did favor the contract?

A. Yes.

Q. There has been received in evidence in this case a contract dated August 12, 1952, which is Exhibit H, attached to Exhibit 107. I think without the necessity of bring that out, I can fully describe it. That is the agreement which provides for the making of two additional pictures and extends the time for making the original pictures under the basic agreement. Are you familiar with that?

A. Yes.

Q. Was that matter discussed with you before the contract was made?

A. Yes.

Q. With whom did you discuss it?

A. I discussed it with Milton Sperling.

Q. And with any other person or persons?

A. With Jack Warner.

Q. What was the substance of the conversation with Milton Sperling on that subject?

A. Just merely the advisability of continuing

(Testimony of Samuel Schneider.)

the production of motion pictures under the same terms as the additional pictures.

Q. What did he say and what did you say on that [1343] subject?

A. He merely would discuss with me what was my opinion of making a picture at that time under the original agreement and borrowing money at the bank. We had a general discussion about conditions in the business and the risk to be taken at that time in the borrowing of money from the bank, and Warner Bros. desiring to continue the receiving of pictures from United States Pictures, if it was possible for them to produce them; and we agreed to continue the contract.

Q. Did you think at that time that was for Warner Bros.' benefit? A. Yes.

Q. Did you discuss the matter with Jack Warner also? A. Yes.

Q. What was the substance of that discussion?

A. Any matter of this type I would discuss with Jack Warner, because we would discuss the properties that United States Pictures has; I would ask Jack Warner what was his opinion of whether United States Pictures could in the next year or so make a picture or two, what does he think of the story that United States Pictures was preparing, and I would obtain from him the opinion as to whether the United States Pictures were in a position to produce additional pictures for our company to [1344] distribute.

Q. What did he say as to that?

(Testimony of Samuel Schneider.)

A. He thought that, after describing the different stories that they were working on and who would be in the cast, he agreed we should extend it so that they could proceed with production.

Q. Do you remember the names of any of the particular pictures he discussed at that time that were in preparation? A. Yes.

Q. What pictures?

A. I remember specifically that we discussed the picture *Three Secrets*. I remember discussing the picture *Distant Drums*, which would be made in Florida with Gary Cooper. We discussed the picture *The Enforcer*, which was based on the story *Murder, Incorporated*; and Jack always knew the properties that United States Pictures had, and whether or not it was worth while for them to proceed with production.

Mr. Levy: Pardon me, Mr. Williams. May it please the court, I think there is a slight confusion in the record.

Mr. Williams: We will take care of the confusion in the record, Mr. Levy.

Mr. Levy: May I indicate what I thought the confusion is to your Honor? [1345]

The Court: You may.

Mr. Levy: Mr. Williams' question to the witness was to the effect, or was designed to bring out from the witness what he had discussed with Milton Sperling at or about August 12, 1952, and I believe the witness misunderstood him, because he went back to the years 1948, 1949 and 1950.

(Testimony of Samuel Schneider.)

I say that creates a confusion in the record; and, to save time on asking a lot of preliminary questions on cross examination on this particular subject, I thought it might be cleared up at this point.

Mr. Williams: That is what I was just about to do, except that counsel is also in error. I was not asking the witness about a conversation with Milton Sperling; I was asking the witness about a conversation with Jack Warner.

Q. The conversation I am now asking you about, Mr. Schneider, is a conversation in August of 1952 when this last extension was made, and the question was, Do you remember now what picture or pictures were discussed as being in preparation at that time?

A. My former answer was based on the many conversations I had with Jack Warner. In 1952 we specifically discussed the very picture he is working on now, *Blowing Wild*; the story we discussed, [1346] *Retreat, Hell*, which I don't recall whether it was at the time of this renewal of the contract, but I remember specifically discussing with Jack Warner the story *Retreat, Hell*, which was based upon events in Korea, and which we were very anxious to get. We thought it was a very timely subject.

Q. Are you familiar with the fact that as late as February of this year an additional amendment of the contract was made providing for the making of the picture *Blowing Wild* in Mexico, instead of at the Warner Studios? A. Yes, sir.

(Testimony of Samuel Schneider.)

Q. Were you familiar with the fact that contract was in process of being negotiated while it was being negotiated? A. Yes.

Q. Did you approve of that contract as being beneficial to Warner Bros.? A. Yes.

Mr. Levy: May it please the court, I did not get Mr. Williams' question just before the last one. The witness answered "Yes," and the next question came in before I could interrupt. May I call upon the reporter to read the question before the last one Mr. Williams put to the witness?

The Court: Will you do so, Mr. Reporter?

(Record read.)

Mr. Levy: The last question is rather confusing, your Honor. We don't know whether it points to terms that were being discussed or the contract that was ultimately negotiated, and I object to it on the ground it is improper in form.

The Court: Do you make a motion that the answer be stricken?

Mr. Levy: I make a motion the answer be stricken, may it please the court.

The Court: The motion is granted, and the objection is sustained.

Q. (By Mr. Williams): Are you familiar with the terms of the agreement as finally drafted?

A. Yes.

Q. The agreement of February 11, 1953?

A. Yes.

Q. Did you approve of that agreement?

A. Yes.

(Testimony of Samuel Schneider.)

Q. In your opinion is that agreement for the benefit of Warner Bros.? A. Yes.

Q. Let me ask you whether in your observation and experience in the motion picture business, whether a producer who produces seven pictures which are [1348] financially successful, box office successes, out of eight pictures produced, whether that is a good average result for a producer?

Mr. Levy: I object to the question on the grounds it is incompetent, irrelevant and immaterial to the issues of the case, and particularly to the issues that are being tried before your Honor at this point.

Mr. Williams: We have a theory on the matter.

The Court: Is the purport of your question whether in that particular industry a producer who has seven financial successes out of eight attempts is considered successful or unsuccessful?

Mr. Williams: Yes.

The Court: Do you object to the question in that form?

Mr. Levy: No, your Honor, I don't.

Q. (By Mr. Williams): Will you answer the question?

The Court: I think the preceding question was objectionable, but you did not object to it. The preceding question called for the ultimate fact in issue here, whether the contract was beneficial to Warner Bros. Pictures, Inc.

Mr. Levy: He was referring to the last contract?

The Court: Yes.

Mr. Levy: This is the August 12 contract——

(Testimony of Samuel Schneider.)

The Court: I am not inviting you to assert it.

Mr. Levy: No, your Honor; I didn't object to it. I want to be very forthright and frank with your Honor that I felt I would take care of it on cross examination.

The Court: I did not imply any criticism. I interpret such a question as meaning, "Did you intend it to be beneficial to Warner Bros.?"

Mr. Levy: That is what I really thought the question was directed to.

The Court: Very well.

The Witness: Shall I answer?

Mr. Williams: Yes.

The Witness: Based upon my experience in the motion picture business and based on the knowledge I have of pictures produced by other companies as well as our own companies, seven financial successes out of eight is very excellent.

Mr. Levy: Now, if Honor please, I move to strike the answer upon this ground: that it assumes a state of facts not in evidence.

The Court: What facts does it assume that are not in evidence?

Mr. Levy: It assumes the following facts not in evidence, namely, that the picture *South of St. Louis* was a success, that the picture *Retreat, Hell*, was a success, that the picture *Distant Drums* has been a financial success, [1350] whereas in the answer to the interrogatories it is indicated clearly and concisely that some of these pictures have not as yet recouped their cost, and there is no evidence

(Testimony of Samuel Schneider.)

now in this record which directly, indirectly, or my implication establishes the fact that seven out of eight pictures that have been produced by the defendant United States Pictures have been or are financial successes.

The Court: Of course, that is a matter of degree. It may be that at a certain stage in the process of recoupment, people who are experienced in the industry, in the business, would term the project a financial success, based upon past experience.

This witness has testified, as I understand his testimony, that he views the seven out of eight photoplays produced by United States Pictures under this arrangement to be financial successes. As he views them, would not the actual figures go to the weight of his testimony rather than to the competency?

Mr. Levy: Again I withdraw the objection.

The Court: You may answer.

The Witness: There was an answer.

Mr. Williams: There was a motion to strike.

Mr. Levy: Then I withdraw my motion to strike.

The Court: Very well.

The Witness: May I explain what I mean by financial [1351] success?

Q. (By Mr. Williams): Yes; please do.

A. Based upon the knowledge I have and the figures I studied before I left New York, seven of these pictures based on the terms of the contract will recoup, the negative cost will recoup all other

(Testimony of Samuel Schneider.)

costs of distribution charges, and will show a profit after that.

The Court: I take it that is based upon your experience with pictures in the past and based upon certain factors, such as how long it has been since they were first released?

The Witness: As a matter of fact, there are only two pictures, *Distant Drums* and *Retreat, Hell*, that have additional income to come in, and taking an approximate amount of the income that will come in, mostly from foreign countries, we are pretty sure about the ultimate result of those two pictures.

The Court: At the present stage in the process of exploitation, you consider that ultimately they will show a profit? That is upon what you base the characterization or measure of success?

The Witness: Yes; and there is very little left to recoup, to obtain that profit.

Q. (By Mr. Williams): Mr. Schneider, you have heretofore testified that you stated in conversation with Mr. [1352] Sperling that you did not think it advisable for United States Pictures to borrow money in the condition of the motion picture industry in 1947 to make additional pictures. What is the fact with reference to Warner Bros. itself as to whether it was to the business advantage or disadvantage of Warner Bros. to produce pictures or finance the production of pictures at that time?

Mr. Levy: I object to the question as improper in form and compound.

The Court: The objection is overruled. The ques-

(Testimony of Samuel Schneider.)

tion, as I understand it, calls for why the Warner Bros. Pictures, Inc., the corporation, was in any different position with respect to borrowing money than the United States Pictures was at that time.

Mr. Williams: Yes.

The Witness: First, I don't think I said I advised him not to borrow money. We discussed the conditions in the business, and we both talked about the fact that it might be inadvisable for United States Pictures to take the risk of borrowing money.

In answer to this question, Warner Bros. Pictures is a vast organization, with the exchanges throughout the world, with the hundreds of theatres that we own, and we were in constant need of product. We had to keep obtaining product to release and to justify our overhead. [1353]

In the case of Warner Bros. Pictures the advancement of money to produce pictures is our regular business, where, to a small independent unit, borrowing of money is quite a risk.

The Court: As you viewed it, then, I take it, the corporation had no choice, but United States Pictures did have a choice with respect to the risk of financing?

The Witness: Yes; our business was financing pictures, whereas with United States Pictures, I don't know whether they had a choice. They had a contract with us. We might have been able to force them to make the pictures, but due to certain circumstances and the falling receipts in our theatres, I, for one, felt that it would be more advantageous

(Testimony of Samuel Schneider.)

to our company to have United States Pictures continue to produce pictures even though we would put up most of the money, providing we could arrange the terms, which we did, and which I think are as favorable or more favorable to our company.

Q. (By Mr. Williams): It is a fact, is it not, that Warner Bros., if it was going to stay in business, had to continue to have pictures?

A. Yes.

Q. Whether they got them by making them themselves or having independent producers make them, they had to have pictures in order to supply their exchanges and theatres? [1354]

A. Yes.

* * * * * [1355]

Cross Examination

* * * * * [1357]

Q. (By Mr. Levy): Do you remember when for the first time you discussed Exhibit 4 or the terms of Exhibit 4?

A. Prior to the signing of this contract.

Q. Prior to December 6, 1947? A. Yes.

* * * * *

Q. Do you know when it was signed?

A. No, I don't.

Q. It is dated December 6, 1947. We have had an instance in this case of the contract having been signed much later than it was dated, and therefore I ask do you know when this contract was signed, of your own knowledge? A. No, I don't.

* * * * *

(Testimony of Samuel Schneider.)

Q. Do you know where, what part of the country you were in on December 6, 1947 or about that time? A. No, I don't. * * * * * [1359]

Q. Now, Mr. Schneider, leaving that aside for the moment, do you know when My Girl Tisa was released first?

A. I think it was around March of 1948.

Q. You are referring to the first general release in the United States of the picture My Girl Tisa?

A. Yes. * * * * * [1363]

Q. And you know, do you not, that this picture was exhibited to the Army and to the Navy before it went into general release?

A. I don't know; but pictures are generally given to the Army and the Navy.

Q. No, no. I am talking about this picture.

The Court: What is "this picture"?

Mr. Levy: My Girl Tisa.

The Witness: I couldn't tell you positively about a picture from memory, but I do know that our pictures are given to the Army and Navy just prior to the release date. It might be, also, at the most, a few weeks.

Q. A few weeks before the release?

A. Yes. * * * * * [1365]

Q. Do you have anybody present for the purpose of getting an audience reaction to the picture when you release it to the Army and Navy?

A. Yes; the soldiers and sailors.

* * * * * [1366]

Q. Warner Bros. keeps a record, does it, of the

(Testimony of Samuel Schneider.)

dates when it receives the completed negative for distribution? A. Oh, yes.

Q. Where is that record located, to your knowledge?

A. I think in the studios here we would have a record as to when the picture was completed, and when it was started.

Q. No, no; I am not asking——

A. And when it was delivered.

Q. Ah, that is what I am talking about, when it was delivered to Warner Bros.

A. To our laboratory, yes. * * * * * [1369]

Q. That date is contained in a book somewhere?

A. Yes.

Q. In the studios?

A. They have the record. * * * * * [1373]

Mr. Williams: I have in my own record here the national release date was February 7, 1948.

The Court: The delivery from the producer to the distributor would antedate that?

Mr. Williams: Yes, it would antedate that.

* * * * * [1374]

The Court: Perhaps you could tell us the importance of it. We are spending a great deal of time on it. * * * * *

The Court: You don't need to go into details. Is it for impeachment purposes, or does it affect some of the contemporaneous transactions, or does it have a bearing on subsequent transactions?

Mr. Levy: Yes; the plaintiff sees in this the

(Testimony of Samuel Schneider.)

probability that in this factual situation, namely, at the time Exhibit 4 was executed——

The Court: On what date?

Mr. Levy: It bears the date December 6, 1947. Warner Bros. and United States Pictures were aware, or had sufficient information to apprehend that My Girl Tisa was going to be a loser and not a winner, and that the additional-pictures contract was made facing that probability; and, if that is so, it would have a bearing [1376] on the bona fides of the parties with respect to the making of this additional-pictures contract, namely, Exhibit 4, and it would have an increased and it would have an additional and it would have a progressive bearing on the subsequent amendments to the contract.

The Court: This Exhibit 4 was subsequently ratified by the Board, was it not?

Mr. Levy: Yes, it was ratified by the Board some two and a half years later.

The Court: What about the minutes of United States Pictures? What do they show?

Mr. Levy: As to what?

The Court: The date of execution, or the date of authorization? * * * * * [1377]

Mr. Schwab: No, I do not believe that they were any board meetings being held with relation to the execution of any of the agreements with stars at the studio or anybody else.

Mr. Levy: We cannot have resort to the minute book of United States Pictures as a possible source of information as to when actually a contract which

(Testimony of Samuel Schneider.)

purports to be dated December 6, 1947 was in fact actually executed. * * * * * [1378]

The Court: While we are talking about it couldn't you, Mr. Williams, call up the studio, or some of these people here call up the studio——

Mr. Williams: I think we could.

The Court: ——and get the record down here while we are spending all this time?

Mr. Williams: I think we could, your Honor. I think we could ascertain that. * * * * *

Mr. Williams: Yes. Of course, my point is that it is utterly immaterial when the print is delivered to the laboratory.

The Court: One of the circumstances, relevant circumstances, [1379] under the plaintiff's theory.
* * * * * [1380]

The Court: I want to be certain that I understand you. At the time Exhibit 7 was executed, it is your testimony that the corporation, Warner Bros., knew that a loss in a substantial sum, something like half a million dollars, would [1381] probably result from *My Girl Tisa*?

The Witness: Yes, on that picture by itself, not figuring any moneys that we might recoup from the profits of other pictures. Oh, yes.

* * * * * [1382]

Q. (By Mr. Levy): So that you would say under those circumstances, having the figures in mind that you have just testified to, that on August 31st, 1948 Warner was in a position to apprehend, was it not, that the chances of the recovering of eight

(Testimony of Samuel Schneider.)

hundred and some odd thousand dollars that it advanced, or the production cost of *My Girl Tisa*, were very, very slim indeed, if any chance did exist? Would you say that?

A. Out of the picture *My Girl Tisa* we were——

Q. That is what I am referring to.

A. ——we were positive that we would not recoup the cost of the picture, even on August 31, 1948.

Q. Right. For the reason, among other things, that the bank got the first money, did it not?

A. Yes; and also because we knew of the business that the picture was doing. [1388]

* * * * *

Q. Mr. Schneider, on August 17, 1950, when Exhibit 7 in evidence, which is the second amendment to the basic contract involving the additional pictures, was approved, were you aware of the fact that the effect thereof would be to postpone the obligation upon the part of United States Pictures to pay to Warner Bros. any deficiency resulting from the loss on *My Girl Tisa* to approximately January of 1947?

A. I was aware that there would be a postponement of the obligation to pay from the release date of the last of the six pictures, whenever released, four years after that, whatever the date would be.

Q. That would bring it down, according to my calculation, to approximately January, 1957.

A. If the last of the six pictures was released four years prior to that.

(Testimony of Samuel Schneider.)

Q. That is right. A. Yes.

Q. You participated, did you not—and if you did not, please say so—in the postponement that was granted to United States Pictures by the terms of the August 12, 1952, contract? It is in evidence here as Schedule H attached to Exhibit 107.

A. Yes.

Q. You were aware then, were you not, that the [1400] postponement that we spoke about previously would have the effect of postponing the United States Pictures' obligation as a fixed obligation to pay Warner Bros. any deficiency resulting from the loss on *My Girl Tisa* to approximately January, 1959?

A. The same answer prevails.

Q. Yes.

A. That there would be a postponement.

Q. Yes.

A. Whatever the deficiency might be.

Q. I ask you this question: Were you aware of the fact that by the terms of paragraph 5 of Exhibit 4 in evidence, namely, the December 6, 1947, amendment, the agreement between United States Pictures and Warner Bros. was to the following effect: Warner Bros. said to United States Pictures:

“You agree that prior to the commencement of the principal photography of any of the photoplays hereinbefore referred to and about to be produced

(Testimony of Samuel Schneider.)

same shall be a remaining photoplay or an additional photoplay as hereinbefore referred to"?

You were aware of that clause in that contract?

A. Yes.

Q. Did that clause mean anything to you from the [1401] point of view of Warner Bros.?

A. Yes.

Q. Were you aware of the fact that under and by virtue of the provisions of that clause, United States Pictures could call upon Warner Bros. to advance 100 per cent of the cost of preparation of any picture that it was engaged in producing—and when I say preparation, I mean from the acquisition of the story, its treatment, its conversion into a screen play, any expense involved in the pre-production of any picture—Warner Bros. would have to advance 100 per cent of all of the cost of that up to the point at which United would walk onto the sound stages and begin turning the cameras? Were you aware that was the situation?

A. It actually doesn't work that way, that they wait until they are on the stage to turn the cameras, but in substance I was aware of the fact that Warner Bros. Pictures could be called upon to advance whatever money was necessary to obtain a story, prepare the story and write a screen play, pre-production expenses, up to the point they would designate whether the picture would be an original or additional picture.

The Court: Whether what?

The Witness: Whether at the time United States

(Testimony of Samuel Schneider.)

Pictures would advise us as to whether or not they choose [1402] to go to the bank and borrow half the money and produce the picture under the terms of the original agreement. I was aware of that.

Q. (By Mr. Levy): Did you consider that of considerable advantage to United States Pictures?

A. No.

Q. You did not?

A. No. I did not consider it of any advantage to the United States Pictures, the fact that they could wait a certain time before they decided under which basis they want to produce the picture.

Q. You did not think it was to the advantage of United States Pictures to have Warner foot the bills in order to get the package, so to speak, in shape before they begin turning the cameras?

A. I don't think that was an advantage.

Q. How long have you been in the motion picture business, Mr. Schneider?

A. 30 years with Warner Bros.

Q. You have spoken to a good many independent producers during your time? A. Many.

Q. You know, do you not, that it is one of the important factors that enter into independent production of a motion picture to have the money that is involved in the [1403] pre-production of the picture, do you? A. Yes.

Q. That is an important element in independent motion picture production, isn't it? A. Yes.

Q. If you haven't got the money with which to prepare a picture up to the point at which you

(Testimony of Samuel Schneider.)

begin turning the cameras on it, you might as well not be in the business; isn't that so?

A. I can't imagine how you could prepare a picture without having any money. [1404]

* * * * *

Q. Who suggested that paragraph be inserted in the contract? Did you?

A. What paragraph is this?

Q. Paragraph 5 that I just read to you.

The Court: Paragraph 5 of what exhibit?

Mr. Levy: Paragraph 5 of Exhibit 4.

The Witness: No, I didn't suggest that paragraph.

Q. Do you know who did suggest it?

A. No, I don't. [1407]

* * * * *

Q. Did you see any advantage to Warner Bros. in giving United States Pictures the option of declaring a picture to be an original picture instead of an additional picture? A. No.

* * * * *

Q. You didn't? I call your attention to paragraph 10 of the agreement.

Mr. Williams: Still referring to Exhibit 4?

Mr. Levy: Still referring to Exhibit 4. [1408]

* * * * *

Q. (By Mr. Levy): Are you aware of the fact that United States Pictures was receiving a decided advantage under the terms of that paragraph? A. No.

Q. Sir?

(Testimony of Samuel Schneider.)

A. No, I wasn't aware that they were receiving a decided advantage.

As I explained before, the whole spirit of the deal was that it was a joint venture, so that whatever we could make available or finance for United States Pictures to enable them to make motion pictures suitable for distribution would be advantageous to Warner Bros. Pictures. [1409]

* * * * *

Q. Were you aware of the fact that under the basic agreement, under the basic contract, United States Pictures had the right to make outside photoplays, that is [1412] to say, outside pictures, pictures in which Warner Bros. would have no interest, financial or otherwise?

A. I knew that the contract provided that.

* * * * * [1413]

Q. Did you ever receive a final and fully itemized statement of the production cost of the picture Cloak and Dagger? A. Yes.

Q. Did you observe on that final and fully itemized statement that United States Pictures had allocated approximately \$116,000, let us say over \$100,000, as United States Pictures' overhead with respect to that picture?

A. I don't recall the amount, but I did see a final statement, if that is the amount,——

* * * * *

A. ——if that is the amount of that statement, then that is what I saw. [1419]

* * * * *

(Testimony of Samuel Schneider.)

Q. Did the thought occur to you that the figure \$116,000 was rather high?

A. Well, now, let me think a moment. I think the picture cost about \$1,800,000, if I recollect. So that the direct cost of that picture would be about \$1,300,000, a million three hundred to a million four hundred thousand. [1420] So that \$116,000 would be about less than 10 per cent.

Q. You thought that was reasonable, didn't you?

A. Well, it is not a question of whether I thought it was reasonable. I knew that in order to run United States Pictures they would have certain expenses.

* * * * *

Q. Expenses sufficient to involve them in a cost of \$116,000 as against one picture as overhead?

A. Well, of course, if he would have produced two pictures in that time that he produced one picture, the overhead would have been 50 per cent of that amount on each picture. As it happened, whatever the circumstances were, he made this one picture, and it is just as difficult to make one picture costing \$1,800,000 as it is to make two pictures costing \$800,000 apiece. There is a lot of things and there is a lot of longer production schedule.

Q. We are talking of overhead, Mr. Schneider.

A. Yes. I say it took United States Pictures a longer time to make this one picture, so that there was a larger amount of overhead charged to a picture, just the same as Warner Bros. Pictures charged a greater amount of overhead to that pic-

(Testimony of Samuel Schneider.)

ture than they would have charged if the picture cost half as much.

Q. Did you at any time know, Mr. Schneider, that United [1421] States Pictures produced two pictures in the year 1946; No. 1, Cloak and Dagger, to which it allocated as overhead \$116,000; and Pursued, to which it allocated in that same year \$129,000 as overhead? The total of those two figures that I gave you is obviously \$245,000. Did you ever pause to think that United States Pictures had reported to Warner Bros. and that report came across your desk, that for the year 1946 United States Pictures had an overhead of approximately a quarter of a million dollars, or, let us say, \$230,000-odd.

A. I don't think the overhead for one year was that much. I don't think they produced two pictures in one year, from my recollection.

Q. Don't you?

A. No. I think it took longer than that, just my memory. I would have to actually look at the record.

Q. If I were to tell you that they had, would that mean anything to you?

A. Well, just let me think a moment. I would imagine that Cloak and Dagger and Pursued took more than a year to produce and absorbed more than one year of the United States overhead, from my recollection.

Q. Mr. Schneider, what do you mean by "absorbed"? What do you mean by your last answer "absorbed more than one year's overhead"? [1422]

(Testimony of Samuel Schneider.)

A. In other words, I think that the two pictures, the amount of overhead that United States Pictures charged to those pictures was more than one year of its overhead. I don't think their overhead amounted to that much in one year, just my own——

Q. If they said that that was the overhead for 1946, if United States Pictures stated in writing and that writing came across your desk, namely, United States Pictures' overhead for the year 1946 is \$235,000, would that have caused you any concern as representing the Warner Bros. office?

Mr. Williams: Just a moment. That is purely speculation, if your Honor please, and objected to on that ground.

The Court: Overruled. He may answer.

A. If I was advised at that time that the United States Pictures' overhead for the entire year of 1946 was \$230,000-some odd, as you stated, I would think it was high, but would also imagine that there are many charges and expenditures in that year which might apply to subsequent productions, such as may be the purchase of scripts or stories.

Q. (By Mr. Levy): Did you at any time prior to December 6, 1947, did you at any time prior to that time know that United States Pictures had included in its overhead for the year 1946 over \$50,000 representing the cost of literary properties that United States Pictures had purchased up to

(Testimony of Samuel Schneider.)

[1423] the end of the year 1946, had not used, but had abandoned them? Did you know that?

A. No. I didn't know that exact fact, although I knew that they were buying literary properties and I wouldn't—during 1947 I wouldn't imagine that they abandoned all the properties that they had purchased, even though they might have written them off.

Q. So you did not know then, Mr. Schneider, that United States Pictures actually abandoned stories during 1946, wrote them off, and included in the overhead for the year 1946 the 50-odd thousand dollars which represented those write-offs? You did not know that?

A. How do you get the knowledge that they abandoned them?

Mr. Levy: They admit it.

Mr. Williams: Now, just a moment, if your Honor pleases. I object to that statement. The witness answered, based on a question, your Honor. I object as not——

The Witness: Warner Bros.——

The Court: Is the fact not in evidence?

Mr. Williams: Not that fact.

The Witness: When Warner—can I state?

The Court: The question is improper if it is not based on facts in evidence.

Mr. Levy: If it is not based on facts in evidence, your [1424] Honor, I shall withdraw the question and I shall apologize humbly.

The Witness: Might I finish my answer there?

(Testimony of Samuel Schneider.)

The Court: Does the defense contend that it is predicated upon facts not in evidence?

Mr. Williams: Yes, if your Honor please.

The Court: What facts?

Mr. Williams: The fact that there was a \$50,000 writeoff in the year 1946 for abandoned stories.

The Court: Mr. Levy, this can go on endlessly. The executives of Warner Bros. are charged with knowledge of whatever the facts were. And what purpose does it serve to go over it with this witness?

Mr. Levy: May I state the purpose?

The Court: Is it to give him a memory test on it?

Mr. Levy: My purpose——

The Court: If you want to ask him hypothetically if he had known the facts were such and such, would he have acted differently, I think that might get us somewhere. But just merely to ask him, time after time, if he knows these things is just a memory test, as I view it.

Mr. Levy: May I state my purpose, your Honor? I really have a purpose, and the purpose is this: To show that this witness was controlled by Harry Warner, to show that he was a "yes" man for Harry Warner. [1425]

The Court: How does conducting a memory test show whether he was? All these things are purely relative. You can say in a treble tone "There is \$250,000," but that may be nothing. It may be exorbitant, it may be outrageous, but it is all rela-

(Testimony of Samuel Schneider.)

tive. Unless it is related to something else, standing alone it means nothing to me.

Mr. Levy: Very well, your Honor.

Q. Mr. Schneider, may I ask you this question: Do you know of any other producer with whom Warner has made an independent motion picture production-distribution agreement who allocated as much as \$204,000 as overhead to a particular picture?

A. I don't think we had a contract of this kind with any other producer.

Q. I asked you this question: Do you know of any case in which Warner Bros. entered into a contract with any independent producer in which the independent producer was permitted to charge, to allocate to a picture as much as \$204,000 as overhead?

Mr. Williams: Now, just a moment, if your Honor please. That assumes that there were other contracts under which independent producers allocated overhead. Counsel well knows, and he has examined the contracts, the other contracts do not provide any such thing, and consequently that question means nothing. [1426]

The Court: Do you mean a single picture?

Mr. Levy: A single picture.

The Court: Overruled. You may answer. Do you know?

A. We have no other contract with a producer, with an independent producer of this type which permits what you just asked.

(Testimony of Samuel Schneider.)

The Court: The answer is "no"?

The Witness: No. [1427]

* * * * *

Mr. Williams: May Mr. Schneider be excused from further attendance?

The Court: Is there any occasion to require him to remain here?

Mr. Levy: I am just wondering, your Honor. The reason why I say there might be some occasion is this: We are trying, as I understood, limited issues here now, and this applies to both this witness and the witness Mr. Friedman who preceded him. They are New York people and [1429] I readily realize that they want to get back as quickly as possible. But we are trying limited issues here.

The Court: Mr. Levy, you may need them tomorrow. We will ask them to remain until tomorrow. I hope that we can reach a conclusion of the evidence tomorrow on this matter.

Mr. Levy: On the issues that we are trying now, your Honor?

The Court: On the two issues, yes; on the issue as to jurisdiction and as to laches or limitation.

* * * * * [1430]

DEPOSITION OF MILTON SPERLING

a defendant in the above-entitled action, taken on behalf of the plaintiff, at 1:30 o'clock p.m. on Wednesday, November 22, 1950, at 4000 West Olive Avenue, Burbank, California, before William H. Burgess, Jr., a Notary Public within and for the County of Los Angeles and State of California, pursuant to the annexed stipulation. [1440]

* * * * *

By Mr. Lyon:

Q. Do you know of any expenses that United States Pictures has which it does not put in as an overhead [1478] expense and charge to pictures produced, to date?

A. All so-called direct costs appear on the budgets as direct costs.

Q. I mean other than direct costs.

A. I do not know of any. [1479]

* * * * *

HERBERT FRESTON—(Recalled)

Cross Examination

* * * * *

Mr. Levy: At this time, your Honor, I offer Exhibits G, H and I that are marked for identification into evidence.

The Court: Is there objection?

Mr. Williams: No, your Honor. [1487]

The Court: Received in evidence.

(Testimony of Morton Barnard Blumenstock.)

Q. What department?

A. Advertising and publicity. [1494]

Q. How long have you been in charge of that department, or those departments?

A. About 15 years.

Q. Prior to that did you work in advertising and publicity for Warner Bros.? A. I did.

Q. How many years all together have you been connected with Warner Bros.?

A. About 28.

Q. In 1945 where was your office?

A. New York.

Q. At that time you had charge of advertising and publicity for Warner Bros.?

A. That is right.

Q. Are you familiar with the fact that about the 28th of September, 1945, an agreement was made between United States Pictures and Warner Bros. for the production by United States Pictures and the distribution by Warner Bros. of certain motion pictures?

A. I was familiar at that time with such a deal.

Q. Did you at that time arrange for publicity to be given to that matter?

A. I did.

Q. Did any person or persons request or suggest that you arrange for such publicity? [1495]

A. I believe Mr. Warner acquainted me with the details of the arrangement which he wanted to announce, our publicity and advertising.

Q. Which Mr. Warner?

(Testimony of Morton Barnard Blumenstock.)

A. Mr. J. L. Warner.

Q. Did you at that time arrange for the placing of advertising in a certain number of trade journals? A. Yes.

Mr. Williams: I would ask the clerk to place before the witness Exhibits D and E for identification.

Q. I ask you, Mr. Blumenstock, to refer first to Exhibit D for identification, and particularly to the back part of that, and I ask you whether you recognize the advertising which appears on the back of that exhibit as advertising which was placed under your direction in the Daily Variety.

A. That is correct.

Q. I will ask you to examine Exhibit E for identification and state whether you recognize the advertisement which appears upon the back of that exhibit as an advertisement which you caused to be placed in the Hollywood Reporter.

A. Yes; they are identical and they appeared in both papers.

Q. Did you have identical ads put in other papers? [1496] A. Yes.

Q. Did those appear on or about the dates that the ads appeared in the Daily Variety, Exhibit D, and the Hollywood Reporter, Exhibit E, both for identification?

A. On or about. I believe they were subsequent to the appearance——

Q. Do you remember their having been in a number of other papers?

(Testimony of Morton Barnard Blumenstock.)

A. I remember that they were, more accurately. I had my office give me a schedule of appearances at that time.

Q. Will you state in what other publications this same ad appeared, and the dates when it appeared?

A. These advertisements appeared, the identical advertisement appeared in *Film Daily*, a New York publication, on October 2nd.

Mr. Levy: Just a moment. I move to strike the answer of the witness on the ground it is not the best evidence, in the first place.

I rest on the objection on that ground.

Mr. Williams: We think it is proper, if your Honor please, in view of the fact that the format and character of the ad has been shown, and that this witness knows that it was placed in the paper.

The Court: Does it appear in this record that the [1497] witness subsequently saw these publications?

Mr. Williams: I will ask that question.

Q. Did you see the publications, the ad as it appeared in the various papers in which it was then placed?

A. You mean at the time of the publication?

Q. Yes. A. That is part of my job.

Q. You did see them?

A. I would have to.

Q. You did? A. Yes.

Q. All right.

(Testimony of Morton Barnard Blumenstock.)

The Court: The motion is denied. The objection is overruled.

Mr. Reporter, was there an answer to the question to which Mr. Levy made an objection?

(The record was read, as follows:

“Q. Will you state in what other publications this same ad appeared and the dates when it appeared?

“A. These advertisements appeared, the identical advertisement appeared in Film Daily, a New York publication, on October 2nd.”)

Mr. Levy: And it was that answer that I made a motion to strike.

Q. (By Mr. Williams): What year; 1945?

A. 1945.

Mr. Levy: And now I move to strike the answer again, if your Honor please, on the grounds that the testimony is incompetent, irrelevant, and immaterial, and has no bearing on the issues that are now being tried.

The Court: Do you expect to offer Exhibits D and E in evidence?

Mr. Williams: I will at this time offer Exhibits D and E in evidence, if your Honor please.

The Court: Is there any objection?

Mr. Levy: No objection to these exhibits.

The Court: Exhibits D and E for identification are now received in evidence. May I see them, Mr. Clerk?

(Defendants' Exhibits D and E for identification were thereupon received in evidence.)

(Testimony of Morton Barnard Blumenstock.)

The Court: You are not addressing your objection to the offer of these exhibits?

Mr. Levy: Not these two, no.

The Court: You are addressing your objection to the pending question?

Mr. Levy: I am referring to the pending question, that is, the question directed to the witness about advertisements made in other publications which are not here present.

The Court: I believe the present state of the record [1499] is that the answers were given and you made a motion to strike on that ground?

Mr. Levy: Yes; I make a motion to strike the answer.

The Court: The motion is denied. The objection is overruled.

* * * * *

A. The other publications in which this advertisement appeared were Weekly Variety, October 3rd issue, 1945. That is a New York publication. Motion Picture Daily, another publication, the same advertisement appeared October [1500] 4, 1945. Box Office, a Kansas City publication, the same advertisement appeared October 6, 1945. Exhibitor, a Philadelphia publication, the same advertisement appeared October 10, 1945. Motion Picture Herald, a weekly New York publication, the same advertisement appeared October 13, 1945. Showman's Trade Review, an eastern publication published in New York City, the same advertisement appeared October 13, 1945.

(Testimony of Morton Barnard Blumenstock.)

Q. The Daily Variety and the Hollywood Reporter, which have been received in evidence as Exhibits D and E, are both California publications?

A. Los Angeles publications, yes. [1501]

* * * * *

SAMUEL SCHNEIDER

recalled to the stand on behalf of defendants, previously sworn, testified further as follows:

Cross Examination—(Resumed)

Q. (By Mr. Levy): Mr. Schneider, I omitted to ask you, prior to December 6, 1947, the date of Exhibit 4 in evidence, were you aware of the fact that Mr. Harry Warner had personally guaranteed an obligation from United States Pictures to the New York Trust Company in the sum of \$150,000, evidenced by a demand note in that sum, dated March 3, 1947?

A. Yes.

Q. You were, of course, aware of that fact, were you not, on August 17, 1950, and you were also aware of that fact on August 12, 1952?

A. Yes.

Q. On or about the dates that I have called your attention to, were you aware of the fact that 62 shares of the capital stock of United States Pictures was held in [1585] trust by the Title Insurance and Trust Company of Los Angeles for the benefit of Mr. Sperling's minor children?

A. I cannot say that I was aware of that fact on those dates.

(Testimony of Samuel Schneider.)

Q. Did you before December 6, 1947, know that 62 shares, or some shares of United States Pictures were being held in trust by the company whose name I have just mentioned, for the benefit of Mr. Sperling's minor children?

A. I was not too familiar with that at any time, and I cannot say that I did not know it, because in conversations with Milton Sperling he mentioned something about that, which was not too significant to me.

Q. Were you aware of the fact that Mr. Bernhard severed his relationship with United States Pictures on or about September 18, 1946?

A. Yes.

Q. Were you also aware of the fact that when he so severed his relationship with United States Pictures he sold his interest in United States Pictures, his stock interest, namely, 125 shares of the capital stock of United States Pictures, to Milton Sperling for the sum of \$400,000 in cash?

A. Yes.

Q. Were you also aware of the fact that in order to pay Mr. Bernhard the purchase price of those shares of [1586] stock, Mr. Sperling had borrowed that sum, namely, \$400,000, from the New York Trust Company?

A. I knew that he was arranging for a loan at the New York Trust Company.

Q. Were you aware of the fact that in order to obtain that loan it became necessary for Mrs. Betty Sperling to pledge collateral owned by her, namely,

(Testimony of Samuel Schneider.)

a share in Warner Pictures Corporation stock, to the New York Trust Company?

A. I was generally familiar with those facts.

* * * * * [1587]

The Court: Do both sides rest on the issues as to jurisdiction, laches, or limitation?

Mr. Williams: Yes, your Honor.

Mr. Levy: Yes, your Honor. * * * * * [1625]

The Court: If we take up the case further on the merits, it would be sometime in July, the last half of July, or in the fall. * * * * * [1629]

JOSEPH CHARLES YOSS

recalled as a witness on behalf of defendants, previously sworn, testified further as follows:

* * * * *

Cross Examination

Q. (By Mr. Levy): Mr. Yoss, you are a vice president of the defendant United States Pictures?

A. Yes.

Q. You are the accountant for United States Pictures? A. Yes. * * * * * [1775]

Recross Examination

The Court: What are you seeking to show?

Mr. Levy: I am seeking to show how much United States Pictures was entitled to receive according to the defendants' theory from all of these additional pictures which they say they have retained to diminish the loss.

The Court: Why don't you ask this witness for

(Testimony of Joseph Charles Yoss.)

the figures, and the conclusion to be placed on the figures is another matter? If you want to ask him what 20 per cent of the net profit was, you may, or however you may wish to [1794] phrase it.

Mr. Levy: Yes, your Honor.

Q. What is the 20 per cent of the net profit on the picture South of St. Louis up to November 29, 1952, Mr. Yoss?

A. Mr. Levy, I don't know what net profits on this picture, or whose net profits on this picture you are referring to.

Q. United States Pictures, Mr. Yoss.

A. Then I must tell you that we have had no net profits yet on this picture.

The Court: Mr. Yoss, do you know what he is asking you? He is asking you what figures represent 20 per cent, whether you have ever received it or not. Don't be captious about it.

The Witness: The answer is \$30,498.18.

Q. (By Mr. Levy): What about Three Secrets, how much?

The Court: Are there several of these you are going into?

Mr. Levy: I think there is one more on which there has been a profit.

The Witness: Calculated on the same basis as the prior answer, except as to date, that would be to November 29, 1952, the answer would be \$34,682.97.

Q. Can you do the same with The Enforcer?

A. The answer on The Enforcer to November

(Testimony of Joseph Charles Yoss.)

29, 1952 [1795] on the same basis, would be \$32,451.18.

Q. Is there any other picture beyond *The Enforcer* of the balance that are in the same class, namely, that have resulted in an excess of gross receipts over the total cost of production and distribution? A. No.

Q. These are the only three pictures, is that correct, in which there has been an excess of gross receipts over and above the grand total of production, distribution allowance, and expenses?

A. Produced subsequent to *Tisa*, of course, excluding *Cloak and Dagger* and *Pursued*.

Q. Yes, excluding those. I am talking of additional pictures.

A. That is right.

Q. The pictures that followed *The Enforcer* were which? A. *Distant Drums and Retreat*, *Hell*.

Q. *Distant Drums and Retreat*, *Hell*?

A. *Distant Drums and Retreat*, *Hell*.

Q. These two pictures have not yet recouped their cost?

Mr. Williams: We are talking as of what date?

Mr. Levy: November 29, 1952.

The Witness: There is a small balance as of November [1796] 29, 1952.

Q. In whose favor?

A. Of costs yet to recoup.

Q. Of costs yet to recoup? A. Yes.

Q. The total of the figures that you have just calculated is what? A. \$97,632.33.

Mr. Levy: I have no further questions. I have no objection to the introduction of this exhibit in evidence. * * * * *

The Court: Is there any further evidence to be offered on the issues as to jurisdiction, limitation, or laches?

Mr. Levy: May it please the court, I have been thinking over very carefully some of the questions your Honor propounded to me yesterday in our discussion with respect to the meaning of hostility, antagonism, etc., etc. I was wondering whether a cross examination of the [1797] principal characters in this drama would shed any light on that particular subject.

In the present state of the record, your Honor has before you the depositions of Harry Warner, Jack Warner, Milton Sperling, and Joseph Bernhard, these being the gentlemen who originally entered into these arrangements, planned this from the very start, and participated in the bringing into being all of the transactions that are at issue in this case.

I have not cross examined any one of these people. It may be that a cross examination of them will yield further light on the question, namely, is there hostility, is there antagonism between the corporation as composed of the individuals who influence its day-to-day conduct and are responsible for its basic policy, are responsible for not only its executive decisions in the making of contracts, but are responsible for the attitude that the corporation

will take when questioned by a stockholder, or when challenged by a stockholder that their behavior was or was not according to the stockholder's conception of what was right under the circumstances.

The Court: I should assume, unless there is some contention expressly made to the contrary, that this corporation would never have brought this suit. Is there any contention to the contrary?

Mr. Levy: That what, your Honor?

Mr. Williams: We don't make such contention.

The Court: That if the stockholder had made demand on the directors and waited any period of time, the suit would never have been brought by the corporation.

Mr. Williams: No, certainly not.

The Court: So far as demand and refusal are concerned, I take it, the defendant, in effect, stipulates that a demand would have been futile.

Mr. Williams: But not for the reasons alleged in the complaint.

The Court: No; but for the reasons contended by the defendant.

Mr. Williams: Certainly not for the reason that the defendants ever contended the contract was fraudulent.

Mr. Levy: I have no further evidence to offer, under those circumstances.

The Court: As I understand the defendants' position, and I can be corrected if I am in error, the defendants' position is that this was an advantageous arrangement to the Warner corporation, and the directors would have upheld it at any time

against any attack by any person, including any group of stockholders.

Mr. Levy: That is the position of both the individual defendants Warner brothers and the corporation— [1799] all of them contend likewise.

Mr. Williams: The individual defendants Warner brothers are not involved in that issue. It is the corporation that is involved in that issue.

The Court: And, for those reasons, no matter what demand the plaintiff stockholder had made on the directors, they would never have brought this suit. Is that a fair statement of it?

Mr. Williams: Yes, that is a fair statement, but not for the reasons alleged in the complaint, that there was domination; but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract.

The Court: By "good", you mean advantageous to the corporation?

Mr. Williams: Advantageous to the Warner corporation, yes.

The Court: If you have closed the evidence, we will proceed with the arguments at two o'clock.

* * * * * [1800]

Mr. Williams: I move for a judgment of dismissal in favor of the defendants in this case, first on the ground that the court has no jurisdiction of the action, and, second, a judgment in favor of the defendants on the ground that the action was brought more than three years after the acts complained of, and is barred by the provisions of the statute of limitations of the State of California and

the statute of limitations of the State of Delaware, each of them being substantially a three-year statute. I simply make those motions formally at this time in preparation for the argument.

The Court: I construe those motions, unless there is objection, to be motions for all of the defendants.

Mr. Williams: All of the defendants, yes.

The Court: First, to dismiss the action for want of jurisdiction over the subject matter, because of laches and diversity of citizenship?

Mr. Williams: Yes, your Honor.

The Court: And, secondly, to dismiss the action on the ground that the charges brought are barred by limitations or laches, as the case may be, or by both limitations and laches, which would be the proper motion, I take it.

Mr. Williams: Yes. * * * * * [1801]

Mr. Levy: May it please the court, your Honor will recall, and Mr. Williams, that I requested the record of the film negative, completed negative, of My Girl Tisa from United States Pictures to Warner Bros. Pictures. You asked Mr. Williams whether that date could not be gotten over the telephone prior to the bringing of the record into this court. We had forgotten all about that. I spoke to Mr. Williams about it this morning and asked him to please produce that record so that it can be made part of the evidence in this case.

The Court: Could someone get that this morning?

Mr. Williams: I can get it today. The record is in [1909] New York, and it is a negative which

was mailed in New York to the laboratory. The laboratory records show the date it was received, November 21, 1947. That I got by telephone, but there was never anything said to me about getting any record.

The Court: No, just the date, as I understood it, without the necessity of bringing the record.

* * * * * [1910]

Mr. Kelly: Now, your Honor, equity is not a one-way street. Usually we have a complainant of this kind asserting acts of fraud. Unfortunately in these suits we have a corporation that is subject to tremendous expense that they can be put to in defending a suit of this kind.

We beg the court, as a court of equity, to consider the equities of the defendants, both the individual directors and the company. We have a perfect example here of—

The Court: The company is not defending the suit, in a sense, is it?

Mr. Kelly: Sir?

The Court: Is the corporation here defending?

Mr. Kelly: It is aligned as the defendant, your Honor. I am pointing out to the court that presumably under the cloak of equity this plaintiff is seeking to do something for the corporation.

* * * * * [1973]

[Endorsed]: Filed April 26, 1954.

[Endorsed]: No. 14334. United States Court of Appeals for the Ninth Circuit. Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, deceased, Appellant, vs. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc., and Warner Bros. Pictures, Inc., Appellees. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: April 28, 1954.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14334

CHARLES B. SMITH, as Special Administrator
of the Estate of Edward S. Birn, Deceased,
Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER,
JACK L. WARNER, UNITED STATES
PICTURES, INC., and WARNER BROS.
PICTURES, INC., Appellees.

STATEMENT OF POINTS ON APPEAL AND
ASSIGNMENT OF ERRORS

The following are Appellants' points in seeking
a reversal of the judgment dismissing the suit upon

the ground that the Court had no jurisdiction of the subject-matter. (Respondent Warner Bros. Picture Corporation is hereinafter referred to as "Warner" and respondent United States Pictures, Inc. is hereinafter referred to as "United".)

I.

It was error for the District Court to align Respondent Warner alongside Appellant because these parties are admittedly on opposite sides of a controversy in which the real matter in dispute is: Whether Warner has been dealt with unlawfully and unfairly, in a joint venture in motion picture production-distribution that was admittedly organized by Respondents Warner and United in 1945 and has been conducted by them ever since.

II.

Facts which are not in dispute disclose the presence of a justiciable controversy between Appellant and Respondent Warner, as a matter of law.

III.

The record discloses certain material facts, each of which is not in dispute and properly the subject of a finding. The learned District Court erroneously omitted to find these facts to be true and to include them in its findings. Considered in the light of these omitted facts, the District Court's findings are rendered insufficient to support the conclusion, to wit: That for jurisdictional purposes, Respond-

ent Warner should be realigned and placed along side the Plaintiff Stockholder.

IV.

The contract between Warner and United (referred to in the findings as "The Contract in Controversy") is illegal. Equally illegal is the series of amendments and supplements thereto which were—admittedly—executed and acted upon by the Corporate Respondents.

V.

The seventy-eight thousand (\$78,000.00) dollar payment by Warner to Joseph Bernhard is illegal.

VI.

Facts which are not in dispute establish as a matter of law that Warner was in hands antagonistic to its financial interests and those of its stockholders. The District Court erred in finding or concluding, to wit:

"nor was said corporation at any time herein referred to in hands or under control antagonistic to the financial interests of said corporation and its stockholders."

VII.

Directors' admissions exhibit and establish Harry Warner as controlling the composition of the Warner directorate and dominating its membership, as a matter of law. In view of said admissions, the District Court erred in concluding that "Neither the corporation nor its directors or officers were shown

to be at that time or at any time under the domination and control of the three Warner Brothers."

VIII.

The findings are insufficient as a matter of law, to sustain the conclusion with respect to the first cause of action, to wit: "That Warner Bros. Pictures, Inc. should be realigned as a party plaintiff."

IX.

The conclusion of law with respect to the second cause of action numbered 1, to wit:—"And therefore the Court finds that United States Pictures, Inc., is a party so necessary and indispensable that a court of equity will not proceed to determination without it; and that without said corporation as a party, the cause of action is without equity." is contrary to law.

MOSS, LYON & DUNN and
HERMAN H. LEVY,

/s/ By HERMAN H. LEVY

Affidavit of Service by Mail attached.

[Endorsed]: Filed June 16, 1954. Paul P. O'Brien,
Clerk.

At a Stated Term, to wit: The October Term A.D. 1953, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City of Los Angeles, in the State of California, on Monday, the second day of August, in the year of our Lord one thousand nine hundred and fifty-four.

Present: Honorable Albert Lee Stephens, Circuit Judge, Presiding; Honorable James Alger Fee, Circuit Judge; Honorable Chase A. Clark, Circuit Judge.

[Title of Cause.]

ORDER SUBMITTING MOTION RE RECORD
ON APPEAL AND GRANTING MOTION
IN PART

Ordered motion of appellant to permit appeal to be prosecuted on original exhibits, etc., submitted to the court for consideration and decision on papers filed, pursuant to oral stipulation of Mr. Herman H. Levy, counsel for appellant, and by Mr. Eugene B. Williams, counsel for appellees.

On consideration thereof, It Is Further Ordered that leave be, and hereby is granted to appellant to prosecute the appeal herein on original exhibits, and that reference to the District Court's opinion in the Federal Supplement be permitted instead of reproducing said opinion in the printed transcript, but that the portion of the motion for hearing of cause on typewritten transcript of the evidence be, and hereby is denied.

No. 14334.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CHARLES B. SMITH, as Special Administrator of the
Estate of EDWARD S. BIRN, Deceased,

Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WAR-
NER, UNITED STATES PICTURES, INC. and WARNER
BROTHERS PICTURES, INC.,

Appellees.

APPELLANT'S OPENING BRIEF.

MOSS, LYON & DUNN, and
HERMAN H. LEVY,

210 West Seventh Street,
Los Angeles 14, California.

Attorneys for Appellant.

FILED

DEC 8 1954

PAUL P. O'BRIEN,
CLERK



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I.

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NER, UNITED STATES PICTURES, INC. and WARNER
BROTHERS PICTURES, INC.,

Appellees.

APPELLANT'S OPENING BRIEF.

Introductory Statement.

Appellant Charles B. Smith, the plaintiff in a derivative stockholders suit, appeals from a final judgment rendered in favor of the defendants-appellees. The judgment was rendered by the United States District Court for the Southern District of California, Central Division.

The original plaintiff was Edward S. Birn, a stockholder of appellees Warner Brothers Pictures, Inc. He died while the action was pending. Appellant Smith was appointed special administrator and duly substituted as the plaintiff.

Jurisdiction.

Jurisdiction was grounded on diversity of citizenship of the parties. U. S. C. A. 1332. Plaintiff Birn was a citizen of New York. The defendants are all citizens of other states: Warner Brothers Pictures Company is a Delaware corporation; United States Pictures, Inc., is also a Delaware corporation; Harry Warner, Jack Warner and Milton Sperling are citizens of California. These facts are pleaded [R. 3-4]; they are not in dispute and have been found [R. 73].

The complaint contains three causes of action. The third cause was dismissed by consent of the parties. It is not an issue in this case. The District Court destroyed diversity of citizenship of the parties to the first cause. It realigned the parties, placed defendant Warner Brothers Pictures Company alongside plaintiff [R. 79]; and having thus arrayed one Delaware corporation against another Delaware corporation, thereupon dismissed the first cause of action for failure of jurisdiction [R. 80-81].

No question of jurisdiction is raised with respect to the second cause. United States Pictures is not named as a defendant in that cause of action [R. 11-12].

Final judgment dismissing both causes of action was entered on January 21, 1954 [R. 81-82]. Notice of appeal was duly filed on February 17, 1954 [R. 101]. Jurisdiction to review the judgment appealed from is conferred upon this Court by 28 U. S. C. A. 1291.

Statement of the Case.

Warner Brothers Pictures, Inc. (hereinafter referred to as "Warner") owns vast motion picture studios in Burbank, California. These house a variety of Warner's facilities and a large personnel employed in picture making. Warner has been producing motion pictures in these studios for many years. The company is publicly owned. Plaintiff Birn was one of its stockholders.

Harry, Jack and Albert Warner are brothers. Their combined stockholdings in Warner give them a working control of the company: between them, they own between fifteen and twenty per cent of its stock. The rest is distributed among some 30,000 shareholders, located all over the world. The brothers direct the supervision, business and policies of Warner. Harry Warner is its president and chief executive.

United States Pictures, Inc. (hereinafter referred to as "United") is wholly owned by Harry Warner's immediate family, namely, Milton Sperling, and his two infant children. Sperling is Harry Warner's son-in-law. The children are Harry Warner's grandchildren.

Since September 28, 1945, corporations Warner and United have engaged in a joint venture in motion picture production-distribution. Since that day, Warner has made these studios, its facilities, personnel and Warner capital available to the joint venture, to an extent approximating some 10 million dollars.

The terms of the venture have not been constant. They were changed from time to time: A *series* of Warner-United contracts (all in evidence), entered into successively, record a succession of *material* and *substantial* changes in the respective rights and obligations of the venturers [Exs. 1, 3, 4, 5, 7, 107 Schedule H].

Some of these contracts to wit: Exhibits 1, 3, 4 and 5, were executed by Warner and United *before* the action was commenced; others, during its pendency.

Appellant's decedent commenced this derivative action on December 15, 1948 [R. 16]. The venture had then been in operation for three years.

The gist of appellant's position in the controversy is that Warner, its facilities, personnel and its capital have been unlawfully used to unjustly enrich Harry Warner's immediate family; that these Warner-United contracts are unlawful and unfair to Warner; that they were performed in a manner unfair to Warner; that they were not "arm's length" transactions; that Harry Warner, as Warner's president, fathered the venture and that terms of these contracts were negotiated by him with his son-in-law Sperling; that self-dealing and overreaching to favor Harry Warner's family at Warner's expense and risk permeated Warner-United dealings; that appellees Harry and Jack Warner were disloyal to their trusts; that Harry Warner's family has been unjustly enriched at Warner's expense; that under the circumstances the "business judgment rule" is not applicable; that a court of equity has the power to and should scrutinize the Warner-United transactions and grant appropriate relief.

Although the suit was brought for its benefit, Warner and the officers and directors who administer its affairs

have been avowedly and admittedly hostile and opposed to its objects. It appeared by the same counsel as represent the brothers Warner who are charged with disloyalty [R. 26]; in the joint answer which was filed [R. 20], and throughout the litigation, Warner took the position (1) it has not been unlawfully or unfairly dealt with; (2) if it has, it lost all right to relief in the premises because of the bar of the Statutes of Limitations of California, New York and Delaware.

In discovery proceedings, following the joinder of issue, Appellant uncovered additional details of Warner-United dealings had both *before* and after the filing of the suit, and Appellant thereupon applied for leave to file an amended and supplemental complaint [R. 36]. The motion was denied without prejudice and with leave to renew [R. 50-51].

Appellant stockholder and Appellee Warner did not collude with the object of creating a controversy between citizens of different states. It is undisputed that it would have been futile for Appellant's decedent to demand of the corporation that it bring this action. Such demand would have been refused [R. 588]. The District Court so found [R. 586-588]; and bringing about concerted action by Warner's stockholders would have been virtually impossible and impractical in view of the fact, equally undisputed, namely, that they number some 30,000 persons located all over the world [R. 120].

The District Court had ordered that only two issues be tried, namely, (1) the Court's jurisdiction; (2) Appellees' plea in bar, to wit, the said statutes of limitations. The parties were directed to present evidence on those two issues *only* [Findings, R. 72].

Following a trial on those two issues, the District Judge filed an opinion in which he concluded (1) to change Warner's position in the suit from defendant to plaintiff, and to align it as such; (2) to dismiss the first cause of action (in which United is a defendant) for failure of jurisdiction; (3) to dismiss the second cause of action (in which United is *not* named as a defendant) on the ground that the exclusion of United as a defendant renders that cause "without equity" (117 Fed. Supp. 781).

The *District Court did not pass upon the merits of the controversy* [R. 81]. In disposing of the first cause of action as aforesaid, the District Judge isolated the *first* of the Warner-United contracts [Ex. 1] from the *series* of such contracts in evidence and with respect thereto, found, in substance [R. 74-75]: that an eleven man Warner board of directors exercising independent business judgment, not dominated by the brothers Warner, "intended" that *particular* contract to be of benefit to the company; "considered" it to be a sound business arrangement; approved it in good faith; found that the company is not in hands antagonistic to its "financial interests" and thereupon concluded, as a matter of law, that Warner is not a defendant but is a plaintiff in the cause; that it should be realigned as such; that since both Warner and United are Delaware corporations, diversity of citizenship does not exist and the cause must accordingly be dismissed for failure of jurisdiction [R. 77].

A series of material facts proven by Appellant and *not disputed* by Appellees are omitted from the District Court's findings. These facts are included in the narrative of the evidence, *infra*.

In disposing of the second cause of action as aforesaid, the District Judge found, in substance [R. 77-78], that *complete relief* cannot be accorded because United is not named as a party defendant in said cause; that United's interest in the controversy is of such a nature that a final decree cannot be made without affecting that interest or leaving the controversy in such a condition that its final determination may be wholly inconsistent with equity, and for those reasons the cause is "without equity."

The District Court's failure to include in its findings undisputed material facts in evidence as well as its findings and conclusions were duly objected to by Appellant [R. 57-71].

Judgment dismissing both causes of action was entered. Thereupon, Appellant moved to amend the pleadings to conform to the proof [R. 84-85]. The motion was denied [R. 100]. Appellant appealed to this Court [R. 101].

The Evidence.

For many years before and since Warner and United became joint venturers, Warner has been making motion pictures in its Burbank studios [R. 117]. The physical product consists of prints of motion pictures, put up in cans [R. 118].

Warner *subsidiaries* and affiliated companies exploit the pictures and distribute them: they book and contract for the rental of the prints to exhibitors throughout the world; they publicize and advertise the pictures and collect the rentals [R. 118-119].

Warner Management.

The brothers Warner direct the supervision of Warner's business and its policies [R. 112]. Harry Warner is Warner's president. He and Jack Warner, a vice-president, reside in California, have charge of company matters on the West coast, and Albert Warner, a vice-president, who resides in New York, attends to company matters in the East [R. 119-120]. Meetings of the Warner board of directors are held in New York. No stenographic notes are taken of the proceedings. Minutes are kept. Albert Warner generally presides (except when Harry is present) and voices collective recommendations of the brothers [R. 151-152, 193].

Up to September 25, 1945, to wit: three days before Warner and United signed their first contract (the subject of the District Court's findings), eleven gentlemen composed the Warner board, namely, Messrs. Friedman, Perkins, Wolf, Guggenheimer, Carlisle, Schneider, Catchings, Bernhard and the three Warner brothers [R. 27].

The first four directors above named are Warner's lawyers [R. 120]: Mr. Friedman is a salaried employee. Warner paid him an annual salary of \$66,000.00. Mr. Perkins is a salaried employee. He is Warner's general counsel. His annual salary is \$66,000.00. Mr. Wolf is the senior member of a law firm which renders professional services to Warner. In 1945, Warner paid this firm \$21,000.00. Mr. Guggenheimer is the senior member of a law firm which is under retainer to Warner. In 1945, Warner paid this firm \$10,000.00 for professional services.

Directors Carlisle, Schneider and Bernhard were salaried employees [R. 120-121]. Carlisle's annual salary

was \$48,200.00; Schneider's salary was \$78,900.00; Bernhard's salary was \$157,100.00. Director Catchings was not on the company's payroll [Ex. 21; App. A].

Warner directors exercised no surveillance over the *performance* of the Warner-United contracts [R. 196, 269, 283, 292, 308].

Harry Warner's Control of Board Membership.

Three board members, namely, Friedman, Perkins and Wolf, admitted, in substance, that Harry Warner's influence was such that if they became *persona non grata* to Harry Warner, their resignations would be forthcoming [R. 490, 304-306, 291-292]. Two directors, namely, Guggenheimer and Catchings, admitted in substance, that their presence on the board was at Harry Warner's pleasure; that they were aware of the fact that Harry was influential enough to prevent their reelection if he chose to do so [R. 283-285, 264].

Director Carlisle admitted [R. 195] that "it is generally Mr. Harry Warner there that is asked if he wishes to make any changes" (in the composition of the board); that Harry Warner, in effect, "controls" the naming of those members of the board who are "inside the organization" and that the witness was mindful of these facts. Mr. Carlisle then admitted to being similarly mindful that "Mr. Harry Warner and his two brothers, in effect, control" whether or not he stays on in the company's employ [R. 195-196].

Director Bernhard resigned and severed his connection with Warner on September 25, 1945 [Ex. 17, App. B] three days before Warner and United signed their first contract.

Harry Warner Fathered the Warner-United Venture.

In the summer of 1945, Sperling, Harry Warner's son-in-law, was anticipating his discharge from military service [R. 122]. About that time, Harry Warner developed an idea, namely, "an individual motion picture production company which would be operated and controlled by Milton Sperling and Joseph Bernhard and which would produce motion pictures at the Warner's studios for Warner distribution" [R. 121-122].

Before Sperling entered the military he had worked for Twentieth Century-Fox, a motion picture company, as a salaried employee [R. 157]. He did not share Twentieth's profits.

Bernhard was a Warner director. He had no experience in motion picture production [R. 126]. He lived in New York. He was general manager of theatres owned by Warner subsidiaries and also handled their real estate matters [R. 333-334]. However, he had good connections with the New York Trust Company. John S. Bierworth, president of that bank, was his friend [R. 122, 343]. The Bernhard-Bierworth friendship had played a part in substantial loans which that bank had theretofore made to Warner [R. 123].

Early in August of 1945, Harry Warner told Bernhard, in substance, that he (Harry Warner) and his brother Jack would approve of a profit sharing venture in motion picture-production distribution between Warner and a company whose profits would be shared equally between Sperling and Bernhard, provided Bernhard could procure the New York Trust Company to loan such a Sperling-Bernhard owned company 50% of the production cost of a series of pictures [R. 124-125].

Bernhard talked to Bierworth [R. 126]; he subsequently told Harry Warner that he had Bierworth's commitment and that the loan would be forthcoming [R. 127]. He "suggested" to Harry Warner that when he (Bernhard) resigns and severs his connection with Warner and associates himself with Sperling. Warner pay him six months' salary, viz., \$78,000.00 [R. 338-339].

The Formation of United.

On August 4, 1945, United was organized as a Delaware corporation [R. 28]. On September 6, 1945, Sperling and Bernhard acquired United's capital stock. Each paid \$12,500.00 and each received 125 shares [R. 28]. This \$25,000.00 was United's total capital [R. 340; 130].

Bernhard, Sperling and Oliver B. Schwab, Sperling's attorney, became United's officers and directors. Mr. Schwab is attorney of record for Appellees United and Sperling [R. 20].

On September 11, 1945, Warner loaned United \$50,000.00 [R. 197-198]. No contract between Warner and United had as yet been even submitted for the approval of the Warner board.

**Bernhard Severs His Connection With United; Whereupon,
Warner Makes Him a Gift of \$78,000.00.**

On September 25, 1945 (three days before Warner and United signed their first contract), a quorum of six directors, namely, Messrs. Albert Warner, Friedman, Perkins, Guggenheimer, Carlisle and Catchings, met in special session. Bernhard's resignation as a Warner officer and director was accepted. A resolution was adopted whereby Bernhard's employment contract with Warner was terminated "by mutual consent" and Bernhard was granted \$78,000.00 "severance pay" [Ex. 17; App. B]. The em-

ployment contract so terminated contained *no* provision with respect to severance pay (App. C). Albert Warner spoke for the brothers Warner; he recommended adoption of the resolution [R. 188-190]. It was adopted unanimously.

Harry Warner Negotiates Terms of the Contract Between Warner and United.

Before the first contract between Warner and United was drawn, the substance thereof was agreed upon in oral conversations between Harry Warner, Jack Warner, Sperling and Bernhard [R. 120]. By August 19, 1945, Harry Warner and Bernhard "had agreed tentatively upon the highlights of the principal provisions of the contract" [R. 391, 393], and on instructions from Harry Warner, Mr. Herbert Freston, attorney for Warner, prepared the first draft. It was completed the following day, August 20, 1945 [R. 393].

Between August 19 and August 30, 1945, Mr. Freston conferred with Bernhard, Harry and Jack Warner, and Mr. Schwab, attorney for Sperling and United, with respect to the contract's provisions [R. 432-435]. On August 30, 1945, Mr. Freston took the last draft to the Warner Studios where he "had a conference with Harry and Jack Warner for about two hours." He "went over the agreement from beginning to end with both of them" [R. 432].

The Warner Board Approves the Contract.

The company's minutes record that three days after Bernhard's resignation, to wit, on September 28, 1945 [Ex. 18; App. D], a quorum met again and approved the contract. Albert Warner, speaking for the brothers Warner, recommended its approval [R. 307].

Warner Stockholders.

Warner is a publicly owned company. Its stock is listed and traded on the New York Stock Exchange [R. 119]. Stockholders, other than the three Warner brothers who own between fifteen per cent and 20 per cent of Warner's stock, number some 30,000 persons located all over the world [R. 120]. Stockholders' annual meetings are held in Wilmington, Delaware.

A proxy committee sponsored and financed by Warner, annually solicits stockholders' proxies. Each year, stockholders received, by mail, a notice of the annual meeting, a printed form of proxy and a "Proxy Statement" which disclosed, among other things, "Transactions between the Corporation and Directors" [Ex. 21; App. A].

Sperling's Connection With the Warner-United Venture Is Withheld From the Stockholders.

The annual meeting of stockholders, following the signing of the Warner-United contract on September 28, 1945, was held in Wilmington, Delaware, on February 19, 1946 [Ex. 21]. The proxy committee mailed stockholders a printed form of proxy and a "proxy statement" [R. 200-201; 30-31]. Under a caption "Transactions Between the Corporation and Directors," the statement revealed to stockholders, in substance, that Warner and United were engaged in a venture in motion picture production-distribution; that Bernhard, a former Warner director, was financially interested in United. The statement contained *no mention* of Sperling [Ex. 21; App. A].

Cross-examination of director Friedman disclosed that he authored this proxy statement; that three Warner directors collaborated in drafting it, namely, he, Perkins, and Carlisle [R. 482]. To the query, namely, whether the

three gentlemen opined that Sperling's *financial interest* in the venture and Sperling's *family relationship* to President Harry Warner "had better not be mentioned," Mr. Friedman replied that after giving the matter consideration, he, Perkins and Carlisle concluded "that it *need* not be mentioned" [R. 485].

Minutes of this stockholders' meeting [Ex. 37H] and minutes of subsequent stockholders' meetings, Exhibits 36a, b, c, d, e, f and g, contain no mention of Sperling. Nor, do such minutes contain any mention of the venture. This fact is stipulated [R. 31].

None of the Warner-United contracts in evidence was approved by the stockholders [R. 31].

Sperling Becomes United's Sole Stockholder.

Approximately a year after Bernhard paid \$12,500.00 for one-half of United's stock, he transferred it to Sperling and received \$400,000.00 in cash [R. 163]. The New York Trust Company also financed this transaction. It made Sperling a loan on his promissory note secured by collateral (shares in Warner) put up by Sperling's wife, Harry Warner's daughter [R. 163-164]. Bernhard resigned as a United director and officer. The Warner-United venture was then some nine months old. The transaction was closed in Mr. Friedman's office [R. 163].

Sperling became United's sole owner and stockholder. On December 26, 1946, Sperling's two infant children—Harry Warner's grandchildren—acquired an interest in United: Sperling transferred 62 shares of United stock to Title and Trust Company of Los Angeles in trust for them [R. 380]; and on March 3, 1947, Harry Warner acquired a *personal* financial interest in United: he en-

dorsed, personally, a \$150,000.00 promissory note made by United to the New York Trust Company, payable on demand [R. 381-382].

The Venture's Terms Are Changed.

Approximately one year before the suit was filed, the first Warner-United contract (the contract which is the subject of the District Court's findings) was superseded by a contract which bears date December 6, 1947 [Ex. 4]. The new contract effected *material* and *substantial* changes in the venture's terms and in the respective rights and obligations of the venturers. Whereas, the terms of the first Warner-United contract had limited the scope of the venture to the making of *six* pictures over a three-year period, expiring in November, 1948; had obligated United to furnish 50 per cent of the venture's capital requirements in producing each of these six pictures and Warner to furnish the remaining 50 per cent [Ex. 1, pp. 2 and 4, App. E], the superseding contract [Ex. 4], among other things (a) broadened the venture's scope by adding three more pictures; (b) extended the venture's life to and including the year 1950; (c) in substance and effect, obligated Warner thenceforth to furnish the *whole*, to-wit; 100 per cent of the venture's capital requirements [Ex. 4; App. F].

Harry Warner and Sperling negotiated the terms of this superseding contract [R. 136]. At the time that it was negotiated and signed by the parties, Harry Warner was obligated to the New York Trust Company on United's \$150,000.00 demand note which bore Harry Warner's endorsement [R. 381-382]. Ever since December 6, 1947, Warner has furnished 100 per cent of the venture's capital requirements.

The superseding contract was not approved by the Warner board prior to the commencement of this action although it had been acted upon for over a year before the suit was filed [R. 191-192]. The District Court made no findings with respect to this contract.

Further Warner-United Contracts Executed Subsequent to the Filing of the Suit and During Its Pendency.

Approximately six months before the expiration of the said superseding contract, Warner and United signed a new contract [Ex. 7]. It is dated July 21, 1950. This action had been pending for over one and a half years [R. 16]. The scope of the venture was again broadened by adding two "additional" (*sic*) pictures. The life of the venture was extended to January 1, 1953, upon the same terms as those contained in Exhibit 4, *i. e.*, among them, Warner's obligation to furnish 100 per cent of the venture's capital requirements.

On August 12, 1952, some four months before the expiration of the contract, above referred to, Warner and United signed another contract [Schedule H, attached to Ex. 107, App. G], which again extended the venture's life, this time to January 1, 1956, on the same terms as provided in the two previous superseding contracts, *viz*, Warner is obligated to furnish 100% of the venture capital. The scope of the venture was further broadened by adding two more "additional" (*sic*) pictures. It now embraces a total of *thirteen* pictures.

Eight of these pictures have been made [R. 353]. Warner contributed 50% of the capital to make the first three; the New York Trust Company furnished the remaining 50%, *i. e.*, the bank loaned United its 50% capital contribution. The loan was conditioned on War-

ner's agreeing, in writing [Exs. 1 and 8] to subordinate its (Warner's) right in each of these pictures and in the net income from its distribution to the bank's prior right to be repaid its loans in full, plus interest; and pending such repayment the pictures, *i. e.*, their negatives and copyrights and said net income be pledged to the bank as security.

The first two pictures were profitable; the third was an almost total loss [R. 354]; it cost \$1,645,066.78 to make [Ex. 107, p. 21] and its net income from distribution was \$419,019.63 [Ex. 107, pp. 32-33], all of which went to the New York Trust Company, pursuant to Warner's promise to subordinate its interest therein to the bank's superior right thereto (App. E).

Under the terms of the first Warner-United contract which prevailed when these *three* pictures were made, United was entitled to receive profits from the *two successful* pictures, *despite the loss suffered in the third picture* [Ex. 1, pp. 23-24, sub. j, App. E].

Profits received by United from the two successful pictures have thus far totalled \$688,067.15 [Ex. 107, pp. 9, 16]; Warner paid United a substantial part of these profits during the years 1947, 1948, 1949 [Ex. 105A].

That losing picture was the last picture made by the venture under terms whereby United was obligated to contribute any capital to the venture [R. 353-354].

The last five pictures have been made under the *superseding* contracts aforescribed. Warner has provided 100% of the capital required to make the last five pictures, over six and a half million dollars [Ex. 107, p. 48].

In addition to profits paid United, *Sperling* admits having received (up to April 2, 1953, the date of answers to requests for admissions), in excess of half a million dollars as salaries and expenses [R. 170] in his twin capacities of "producer" of pictures and "executive" of United.

This money was charged into the production cost of pictures made and was paid *Sperling* pursuant to the provisions of subparagraph 4½ of paragraph 7; Exhibit 1, pages 15-16 of the first Warner-United contract [App. E] and incorporated by reference in the superseding contracts. This paragraph provides, in substance that United "overhead," not limited in terms of dollars, is chargeable into the production cost of the pictures and that *Sperling's* "executive" salary, also not limited in terms of dollars, be considered a part of such overhead [R. 356-358].

Though all of the Warner-United contracts provide that the actual production of the pictures shall be within United's [in reality *Sperling's* R. 361] *exclusive* control, *none* of the Warner-United contracts contains a provision entitling Warner to examine United's books of account [Ex. 1, par. 4, pp. 8-9, App. E]. Nor do these contracts contain a provision obligating United to furnish Warner a breakdown, *i. e.*, a detailed itemization of United's "overhead" expenditures or of United's "direct" expenditures.

Warner admits that it has been ignorant of these details *throughout the performance* of these contracts; that United has not supplied them [Ex. 107, pp. 3-6, 12-15, 23-25, 33]. Profits received by United were calculated on the basis of United's statements of expenditures which do not disclose these details.

Specifications of Error.

I.

THE DISTRICT COURT ERRED IN CONCLUDING THAT THE SUIT IS NOT BETWEEN CITIZENS OF DIFFERENT STATES. THE JUDGMENT DISMISSING THE FIRST CAUSE OF ACTION IS CONTRARY TO LAW.

The record exhibits and establishes Appellant and Appellees are on opposite sides of a justiciable controversy in which the real matter in dispute is, whether the stockholders' corporation was used unlawfully to enrich the family of its chief executive officer; that the corporation and the officers and persons controlling it are hostile and opposed to the objects of the suit.

II.

THE DISTRICT COURT ERRED IN CONCLUDING THAT "NEITHER THE CORPORATION NOR ITS DIRECTORS OR OFFICERS WERE SHOWN TO BE AT THAT TIME OR AT ANY TIME UNDER THE DOMINATION AND CONTROL OF THE THREE WARNER BROTHERS."

Directors' admissions exhibit and establish the brothers Warner as controlling the Warner corporation and its directorate.

III.

THE DISTRICT COURT ERRED IN DISMISSING THE SECOND CAUSE OF ACTION ON THE GROUND THAT THE SAME IS "WITHOUT EQUITY."

It was error for the District Court to conclude, in substance, that because a decree which would accord "complete relief" in the controversy could not be made, it would be inconsistent with equity and good conscience to grant relief, though short of complete relief.

ARGUMENT.

I.

The Record Exhibits and Establishes Appellant and Appellees Citizens of Different States, on Opposite Sides of a Justiciable Controversy. The District Court Erred in Concluding That It Lacked Jurisdiction. 28 U. S. C. A. 1332.

Jurisdiction is "the right to put the wheels of justice into motion and to proceed to the final determination of a cause upon the pleadings and evidence," Mr. Justice Brown in *Illinois Central Railroad v. Adams* (1900), 180 U. S. 28, at 34. It exists in the District Courts of the United States if the plaintiff be a citizen of one state, the defendant a citizen of another, if the amount in controversy exceed \$3,000.00, and the defendant be properly served with process within the district.

Ever since the Supreme Court's decision in the *Removal Cases*, 100 U. S. 457, 25 L. Ed. 593, federal courts have tested jurisdiction in derivative suits grounded on diversity of citizenship, in accordance with the rule laid down by Chief Justice Waite, namely, that the District Court will "ascertain the real matter in dispute and arrange the parties on one side or the other of that dispute" (*Pacific R. R. Co. v. Ketchum*, 101 U. S. 289, 290); the "pleadings may be put aside, and the parties placed on different sides of the matter in dispute, according to the facts" (*Removal Cases, supra*, at p. 469).

Whenever the inquiry into the District Court's jurisdiction disclosed the stockholder's corporation to be hostile; whenever the facts revealed that the officers who controlled the corporation were opposed to the objects of the suit, the corporation has been held to be properly

aligned with the defendant. In the absence of proof of such opposition, the corporation has been aligned with the complainant. (*Groel v. Electric Co.*, 132 Fed. 252, 263-264.)

The *Groel* case, *supra*, was decided some twenty-five years after the *Removal Cases*. In that case, the complaining stockholder, a citizen of New Jersey, had instituted a derivative suit in the New Jersey Court of Chancery. The defendants named were his corporation, a New Jersey company, and a Pennsylvania corporation. The case had been removed from the state court to the Federal District Court of New Jersey. Plaintiff stockholder moved to remand on the ground that both he and the defendant New Jersey corporation were citizens of New Jersey. In opposition to the motion, it was contended that since the stockholder was urging not his but the corporation's cause of action, the Federal Court should view the stockholder's corporation as a plaintiff and realign it with the complainant, thus bringing about diversity of citizenship.

The Court declined to do so. It said (p. 263):

"This contention has seemed to necessitate the foregoing review of the authorities. The rule deduced from them is that, in a suit in equity instituted by a stockholder in his own name, but upon a right of action existing in his corporation, the stockholder's corporation will be aligned with the defendants whenever the officers or persons controlling the corporation are shown to be opposed to the object sought by the complaining stockholder, and that, when such opposition does not appear, the stockholder's corporation will be aligned with the complainant in the suit."

(132 Fed. at 263, 264.)

Applying the rule, Judge Lanning held that since the New Jersey corporation was opposed to the objects of the suit; it was a defendant; had been properly aligned as a defendant and, consequently, the Court had *no* jurisdiction. The case was remanded to the state court.

The *Groel* case, *supra*, was cited with approval by the Supreme Court in *Venner v. Great Northern Rwy. Co.* (1908), 209 U. S. 24.

In the *Venner* case, *supra*, the complaining stockholder, a citizen of New York, had instituted a derivative suit in the New York Supreme Court. The defendants named were his corporation, a Minnesota corporation, and its president, a Minnesota citizen. The case had been removed to the United States Court for the Southern District of New York at the instance of the defendants. There, the defendants demurred to the bill on the ground that complaint had failed to comply with Equity Rule 94, whereupon, the complainant moved to remand upon the ground that the Court had no jurisdiction. Complainant urged, in substance, that the Court should view the corporation as a plaintiff and realign it as such because the corporation's interests were equatable with those of the stockholder; that accordingly stockholder and corporation should be regarded as opposed to the co-defendant. The Court rejected this contention and held that the District Court had jurisdiction.

Mr. Justice Moody, writing for a unanimous court, said at pages 31-32:

"First, was there a controversy between citizens of different states? As the parties were arranged by the plaintiff himself on the face of the record there was diversity of citizenship. The plaintiff was a citizen of New York and the two defendants were

citizens of Minnesota. But the plaintiff insists that by looking through the superficial aspects of the controversy to its real substance it is seen that the railway company's interest is adverse to that of the other defendant, and the same as that of the plaintiff, and that therefore for the purpose of determining jurisdiction, the defendant railway should be regarded as plaintiff. If this should be done there would be a citizen of Minnesota a plaintiff and another citizen of Minnesota a defendant and the diversity of citizenship which is indispensable to the jurisdiction of the Circuit Court would no longer exist. * * *

Let it be assumed for the purposes of this decision that the Court may disregard the arrangement of parties made by the pleader, and align them upon the side where their interest in and attitude to the controversy really places them, and then may determine the jurisdictional question in view of this alignment. Removal Cases, 100 U. S. 457 * * *

If this rule should be applied it would leave the parties where the pleader has arranged them. It would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail. But that is not enough. *Both defendants unite*, as sufficiently appears by the petition and other proceedings, in *resisting* the plaintiff's claim of illegality and fraud. They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. *The plaintiff's controversy is with both* and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant * * *

The case of Doctor v. Harrington, is precisely in point on this branch of the case, and is conclusive. * * *"

(Emphasis added.)

Counsel urge that the rationale in the *Groel* and *Venner* cases, *supra*, is identical. In both cases, the emphasis is on the fact that the corporation was a *resistant*—that it was antagonistic and opposed to the objects sought in the suit. Whereas the complainant stockholder sought a decree adjudging his corporation's conduct to have been unlawful, the corporation sought an adjudication to the contrary. Hence, it was properly aligned with the other resistants.

The opinion of this Court in *Cutting v. Woodward*, 255 Fed. 633, made this crystal clear when it said, that the *attitude* of the stockholder's corporation in that case—its avowed hostility, as made manifest by its denial of the stockholder's charge of wrongdoing, its prayer that relief be denied, its joining forces with the individual defendant charged with tortious behavior, demonstrates that the corporation is an adversary party.

“The trust company raises the question of jurisdiction, asserting that the company is not an adversary party to the plaintiffs in the suit, but is the real party in interest as plaintiff, and that consequently there is no diversity of citizenship. But this is not a case in which the trust company, although made a defendant, should be realigned as a plaintiff, as in *Hamer v. New York Railways*, 244 U. S. 266, 274 * * *. Here the attitude of the trust company is hostile to the plaintiffs. It appeared in a joint answer with the appellant and by the same counsel and it denied the allegations of the bill and prayed for the dismissal thereof. The cause is therefore one in which plaintiffs, citizens of Illinois, bring suit against defendants who are citizens of Cali-

fornia. Doctor v. Harrington, 196 U. S. 579,
* * *; Venner v. Great Northern Railway, 209
U. S. 24 * * *.”

To the same effect, see the opinion of Mr. Justice Gray in *New Jersey Central Railroad v. Mills*, 113 U. S. 249, at 256-257.

Appellant urges that the law as expounded in these cases, applied to the evidence in this preliminary inquiry into the Court's jurisdiction justifies a reversal of the judgment. Evidence consisting of *undisputed facts* exhibits that the requisite essentials as prescribed by the Act of Congress conferring jurisdiction upon the Court below are present. These essentials are:

(A) A controversy between citizens of different states.

(B) The *real matter in dispute* is whether Warner was used unlawfully to enrich the family of its chief executive at Warner's expense, risk and to its detriment.

(C) Complainant stockholder and the defendants named are on opposite sides of that dispute.

(D) The controversy is justiciable.

(E) The officers and persons controlling Warner are hostile and opposed to the objects of the suit.

A, B, C. Evidence Consisting of Undisputed Facts Exhibits Complainant Stockholder and the Defendants on Opposite Sides of a Controversy in Which the Real Matter in Dispute Is Whether Warner Has Been Used Unlawfully to Unjustly Enrich the Family of Its Chief Executive.

The record exhibits beyond peradventure that this was the bone of contention—the real matter in controversy; the stockholder contending that the Warner-United dealings which are embraced and identified in the proof were unlawful and permeated with self-dealing and overreaching to bring about Sperling's unjust enrichment at Warner's expense and risk; the corporation contending, in opposition, (1) that these dealings were lawful, fair to Warner and of benefit to it; (2) that if the dealings were unfair, Warner's right to relief in the premises has been barred by the statutes of limitations of three states.

D. The Controversy Is a Justiciable One.

It is well settled that in a controversy between a stockholder, and his corporation, its president and others in which the legality and fairness to the corporation of transactions growing out of contracts between the corporation and its president or members of his immediate family are challenged; in which it appears that terms of such contracts had been negotiated by the president, a court of equity will not invoke the "business judgment rule" but will lay it aside and will scrutinize such transactions with a view to determining their legality and their fairness to the corporation and grant appropriate relief.

Underlying equity's intervention in such situations is the recognition that inherent in the birth and during the life of such transactions is an unavoidable conflict between an individual's natural desire to secure advantage

to self, or to those closely related to him, and that individual's obligation, as a corporate trustee, to see to it that his corporation secures the best possible terms in the trading. The evolution of the law with relation to this phase of human relations exhibits chancery's age-old struggle to preserve against "erosion" a natural resource in a healthy, competitive society, namely, the concept of undivided loyalty due the beneficiary at the hands of the chosen trustee.

Pepper v. Litton, 308 U. S. 295, 306;

Remillard v. Remillard-Dandini, 109 Cal. App. 2d 405, 419, 420;

Meinhardt v. Salmon (1928), 249 N. Y. 458, 164 N. E. 545; 62 A. L. R. 1;

Globe Woolen Co. v. Utica Gas & El. Co., 224 N. Y. 483;

Bayer v. Beran (1944), 49 N. Y. S. 2d 2, 9;

Guth v. Loft, Inc. (1939), 23 Del. Ch. 255, 5 A. 2d 503;

Voorhees v. Nickson (1907), 72 N. J. Eq. 791, 66 Atl. 192, 193;

Stone. The Public Influence of the Bar, 48 Harv. L. Rev. 1, 8.

E. The Officers and Directors Controlling Warner Are Hostile and Opposed to the Objects of the Suit.

The record exhibits that the corporation and those who administered its affairs were not only at odds with the stockholder over "the desirability" of bringing the suit (Opinion 117 Fed. Supp., at p. 802) or over "the advisability" of bringing the suit (*id.* at p. 803), but that they are active resisters to complainant's claim, to

wit: that the *group** of Warner-United contracts in evidence as Exhibits 1, 3, 4, 7 and Schedule H, attached to Exhibit 107, is unlawful; they are unfair and were unfairly performed; that the \$78,000.00 paid to Bernhard when he resigned as a Warner director to join Sperling in the Warner-United deal was an unlawful *gift* of corporate funds. Their position in the suit is, in short, that complainant's claim is without merit; that these are sound business transactions; that these Warner-United dealings have not injured the company as claimed by the stockholder; on the contrary, the company has been benefited by them; and if they are unlawful, the court is powerless to grant any relief because of the statutes of limitations.

Appellant urges that the effect of the District Court's holdings is to add to the foregoing jurisdictional essentials, a *further prerequisite*, namely, management's resistance to the object of the suit must be shown to be generated by *sinister motives*.

Counsel respectively submit that after painstaking research into the law relating to alignment of parties for jurisdictional purposes, no case has been found which has suggested that a stockholder in a derivative suit who has aligned his corporation as a defendant has the burden of proving by the preponderance of the evidence, and *in limine*, that the resistance to the objects of the

*The District Court's findings [R. 74-75] refer to but the first of the group, namely Exhibit 1.

suit by those controlling the corporation, through avowed and admitted, proceeds from sinister motives.

In *Delaware & Hudson Co. v. Albany and Susquehanna*, 213 U. S. 425 at 451, Justice McKenna, writing for a unanimous court, says:

“The attitude of the directors need not be sinister. *It may be sincere*. It was so in *Chicago v. Mills*, 204 U. S. 321, and *ex parte Young*, 209 U. S. 123, and other cases. In this case it was certainly determined. It continued until after this suit was brought. Both the Delaware Company and the Susquehanna Company, then under the ‘administration of the Delaware Company,’ to quote from the Circuit Court of Appeals, demurred to the bill.” (Emphasis added.)

In *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, at 319, Chief Justice Hughes says:

“In such a case it is not necessary for stockholders—when their corporation refuses to take suitable measures for its protection—to show that the managing board or trustees have acted with fraudulent intent or under legal duress. To entitle the complainants to equitable relief, in the absence of an adequate legal remedy, it is enough for them to show a breach of trust or duty involved in the injurious and illegal action. Nor is it necessary to show that the transaction was *ultra vires* of the corporation. * * * The fact that the directors in the exercise of their judgment, either because they were disinclined to take a burdensome litigation *or for other reasons* which they regarded as substantial resolved to comply with legislative or administrative demands, has not been deemed an adequate ground

for denying to the stockholders *an opportunity to contest* the validity of the governmental requirements to which the directors were submitting." (Emphasis added.)

In *Schmidt v. Esquire, Inc.*, decided in 1954, the Court of Appeals, 7th Circuit, after considering the pronouncements of the Supreme Court in the *Ashwander* case, *supra*, the *Delaware v. Susquehanna* case, *supra*, among others, and the reasoning of the Court in the *Groel* case, *supra*, said:

"It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives."

The thrust of these decisions is aimed at securing the alignment of the corporation in accordance with the realities of the situation: the corporation remains aligned as a defendant when, in reality, it is a resistant; whenever those who administer its affairs array it as such; when they manifest by word, act and deed that they are opposed to the objects of the suit. This is the essence of the holdings of the Supreme Court and of this Court.

II.

Directors' Admissions Exhibit and Establish the Brothers Warner as Controlling the Warner Corporation and Its Directorate, as a Matter of Law. In View of These Admissions, the District Court Erred in Concluding That "Neither the Corporation nor Its Directors or Officers Were Shown to Be at That Time or at Any Time Under the Domination and Control of the Three Warner Brothers."

Assuming but not conceding, that control of the stockholder's corporation by the codefendants who are charged with a breach of trust is a factor in determining whether the Court has jurisdiction, appellant urges that directors' admissions exhibit the Warner corporation and its directorate as being controlled by the brothers Warner.

Counsel urge that a board of publicly owned and listed company composed of ten members, three of which reluctantly admit, in substance, that their continued connection with the company depends on their not becoming *persona non grata* to the company's president who, together with his two brothers, have a working control of the company; another two of which likewise admit, in substance, that their presence on the board is at the president's pleasure; that they are aware that the president and his brothers can readily prevent their election as directors if they chose to do so; and the seventh of the ten admits that the president, in effect, "controls" the naming of the "inside" directors; that the president and his two brothers control whether or not he stays in the company's employ, is in reality and to all intents and

purposes, a board controlled by its president and his brothers.

Director Carlisle admitted in substance, that Harry is the man who controls the composition of the board. He admitted *in so many words*, that his continued presence in the Warner organization was at the pleasure of the Warner family [R. 195-196]. Mr. Friedman phrased it differently when he said he would resign if he became *persona non grata* to any of the Warners [R. 490]. Mr. Perkins put it, that he would not remain in the company's employ if the Warner family indicated opposition [R. 304-306]. This was similarly the substance of Mr. Wolf's testimony [R. 291-292]. And the substance of directors Guggenheimer [R. 283-285] and Catchings testimony [R. 264] is that their continued presence on the board was virtually at Harry Warner's pleasure.

Appellant contends that such a board is confessedly, in last analysis a sterilized board; for these factors impair the roots and tend, inexorably, to destroy the stuff that directorial freedom and independence are made of, viz.; the consciousness of being untrammelled and uninhibited in functioning as trustees for all the stockholders.

None of the gentlemen above referred to, faced the Court except Mr. Friedman. Their depositions were read. Appellant urges that reflected in what the deponents said is the compelling fact namely, here was an influence, dominating, potent and persuasive exerted by Harry Warner from beginning to end. And while it is true, that neither Harry Warner nor his brother Jack was present at the board meetings at which the 1st Warner-United contract and the \$78,000.00 gift to Bernhard were ap-

proved, and did not vote thereon, the New York Court of Appeals, in a not unsimilar situation, observed "A dominating influence may be exercised in other ways than by a vote." Cardozo, J., in *Globe Woolen v. Utica Gas & El. Co.*, *supra*.

For the reasons urged herein in numbers I and II, it is respectfully submitted that the learned Court erred in concluding that it had no jurisdiction of the first cause of action.

III.

The District Court Erred in Dismissing the Second Cause of Action on the Ground That It Is "Without Equity."

The District Court's realignment of the defendant Warner did not destroy its *jurisdiction* over the second cause of action.

Whether Warner be aligned as a plaintiff or as a defendant therein, the stockholders' plea in this second cause is, that his corporation was used unlawfully to accomplish the unjust enrichment of Harry Warner's son-in-law; that this was done through a series of transactions had between Warner and United States Pictures Co., Inc., a company virtually owned by the son-in-law; that as a result of these transactions, Warner corporation has been injured; and the relief obviously sought in this second cause is no more than, that trustees Harry and Jack Warner be adjudicated to have been guilty of a breach of trust and be ordered to respond in damages for their misconduct.

It is thus seen that the second cause of action seeks nothing from *United*.

The District Court's conclusion to dismiss this cause is predicated on two identifiable grounds: (1) that were the court to proceed to final decision therein without the presence of United, the controversy would be left "in such a condition that its final determination would be wholly inconsistent with equity and good conscience;" and (2) that the court would thereby be doing violence to "that equity which seeks to put an end to litigation by doing complete and final justice."

Reflected in both of these grounds is the learned court's reasoning, that if the two defendants, the brothers Warner, were guilty of a breach of trust, then United, which benefited thereby, "ought to be" before the court so that it may be compelled to restore its ill-gotten gains and so that both the Warner corporation and United may be directed to, so to speak, sever their unholy alliance.

At page 810 of its opinion, the learned Court said:

"While not an *indispensable party* in the sense of 'having a joint interest' and for that reason subject to 'necessary joinder' by the terms of Rule 19(a), United is clearly a person who 'ought to be' a party within the meaning of Rule 19(b)." (Emphasis added.)

Appellant urges, however, that the fact that United *ought to be* a party in order that Warner corporation obtain the *ultimate* in relief, viz., not merely the money that it has lost as the result of this breach of trust, but the money that it may continue to lose as the result of obligations which Warner has assumed in contracts entered into with United, should not operate to deprive Warner of such relief as the Court is empowered to grant.

In *Paine v. Hook*, 74 U. S. 425, at 431, the Supreme Court said:

“But it is said the proper parties for a decree are not before the court, as the bill shows there are other distributees besides the complainant. It is undoubtedly true that all persons materially interested in the subject-matter of the suit should be made parties to it; but this rule, like all general rules, being founded in convenience, will yield, whenever it is necessary that it should yield, in order to accomplish the ends of justice. *It will yield, if the court is able to proceed to a decree, and do justice to the parties before it, without injury to absent persons, equally interested in the litigation, but who cannot conveniently be made parties to the suit.*

“The necessity for the relaxation of the rule is more specially apparent in the courts of the United States, where, oftentimes, the enforcement of the rule would *oust them of their jurisdiction*, and deprive parties entitled to the interposition of a court of equity of any remedy *whatever*.” (Emphasis added.)

Appellant urges that the Supreme Court's decision in the *Paine case*, *supra*, is peculiarly applicable to the situation before the Court in this case, for the judgment creates the unique situation, namely, that not only United, which is *not* before the Court, but defendants Harry and Jack Warner, who *are* before the Court, become virtually immune against being made answerable for their delicts. A situation is created in which, were the stockholder to apply for relief to the California state court (where he can obtain jurisdiction of the persons of all the parties), that court would be rendered powerless. The statute of limitations would, in all probability, afford

the defendants formidable sanctuary as to a very substantial part of their misconduct.

Counsel urge that the true rule as to indispensability of parties calls for a reconciliation between the desirability on the one hand of obtaining a complete and final decree between all parties who may have an interest in the controversy, and on the other hand, of having some adjudication, if at all possible, rather than none, thereby leaving the parties remediless because of an ideal desire to have all interested persons before the Court. Moore's Federal Practice, Vol. 3, 2154-5 (2nd Ed. 1948).

In *Young v. Powell*, 179 F. 2d 147 (5th Cir., 1950), at page 151, the Court views the problem as follows:

“* * *. ‘The fundamental principles are simple. They are: (1) where federal jurisdiction rests on diversity of citizenship the diversity must be complete, and to see whether it is, all parties will be aligned as plaintiffs or defendants according to their real interests; (2) a court cannot adjudicate the rights of persons who are not parties before it; they will be brought in if possible and if they will not destroy diversity. (3) if diversity will be thereby destroyed the court will not require them to be brought in, but will inquire if there is any relief it can properly give without them; if there is, it will give it without prejudice to the rights of the absent; if none can be given the suit will be dismissed. In the latter event the dismissal is not for want of federal jurisdiction, but for lack of indispensable parties. (See Federal Rules of Civil Procedure, No. 19, 28 U. S. C. A.)”

In *Wesson v. Crain*, 165 F. 2d 6, at page 9, the Court stated:

“* * *. In *Bourdieu v. Pacific Western Oil Co.*, 299 U. S. 65, 70, 71, 57 S. Ct. 51, 53, (81 L. Ed. 42), Mr. Justice Sutherland, speaking for the court, said. ‘The rule is that if the merits of the cause may be determined *without prejudice to the rights of necessary parties*, absent and beyond the jurisdiction of the court, it will be done; and a court of equity will strain hard to reach that result. *West v. Randall*, Fed. Cas. No. 17,424, 2 Mason 181, 196 (opinion by Mr. Justice Story); *Cole Silver Mining Co. v. Virginia* and *G. H. W. Co.*, Fed. Cas. No. 2,990, 1 Sawy. 685, 689 (opinion by Mr. Justice Field); Story’s Equity Pleading (8th Ed.), Secs. 77, 96. And see *Russell v. Clark’s Executors*, 7 Cranch 69, 98 (3 L. Ed. 271); *Elmendorf v. Taylor*, 10 Wheat. 152, 167, 168 (6 L. Ed. 289). Cf. Equity Rule 39 (28 U. S. C. A., Sec. 723 (Appendix).)” (Emphasis added.)

For the foregoing reasons, Appellant contends that the learned District Court erred in dismissing the second cause of action on the ground that it is “without equity.”

Respectfully submitted,

MOSS, LYON & DUNN and
HERMAN H. LEVY,

By HERMAN H. LEVY,

Attorneys for Appellant.



Appendix A.

WARNER BROS. PICTURES, INC.

Notice of Annual Meeting of Stockholders.

New York, N. Y., January 10, 1946.

To the Stockholders of Warner Bros. Pictures, Inc.

Notice Is Hereby Given that the Annual Meeting of Stockholders of Warner Bros. Pictures, Inc. will be held at the principal office of the Corporation at 100 West 10th Street, Wilmington, Delaware, on Tuesday, February 19, 1946, at 11 o'clock in the forenoon, for the purposes, as set forth in the attached proxy statement, of electing six directors of the Corporation and of transacting such other business as may properly come before the meeting.

If you do not expect to be present in person at the meeting, the Board of Directors requests that you date, fill in, sign and mail the enclosed proxy.

Stockholders of record at the close of business January 11, 1946 will be entitled to vote at such annual meeting.

R. W. PERKINS,
Secretary.

PROXY STATEMENT.

The Annual Meeting of the Stockholders of Warner Bros. Pictures, Inc. will be held at the principal office of the Corporation at 100 West 10th Street, Wilmington, Delaware, on Tuesday, February 19, 1946, at 11 o'clock in the forenoon. At the time of this statement the only business which the management intends to present, or is informed that others will present, at the annual meeting,

is the election of six directors to serve for a term of two years.

The proxy is revocable and the solicitation thereof is on behalf of the management of the Corporation. Proxy solicitation will be made by mail, telephone (at a nominal cost) and personal solicitation by officers and employees of the Corporation and by Mr. John E. Morrison, Sr., of 15 Broad Street, New York City, who has been engaged for this purpose. The Corporation will pay Mr. Morrison \$1,200, plus his reasonable disbursements. The expenses for preparing, handling and mailing the proxy statement and the proxy and the charges of brokerage houses and other custodians will also be paid by the Corporation.

There are outstanding, after deducting shares held in the treasury, 3,701,090 shares of common stock of the Corporation.

The Annual Report of the Corporation for the fiscal year ending August 31, 1945, which is not part of this proxy statement, is enclosed.

The designation of the proxy committee was made by the Board of Directors of the Corporation, and it is the intention of the proxy committee, unless specifically instructed to the contrary, to vote proxies received in favor of the election of the nominees named below and to vote proxies received, in their discretion, upon such matters not now known or determined which may properly come before the meeting.

The Board of Directors has nominated for re-election to the Board of Directors, to serve for a term of two years, John E. Bierwirth, Waddill Catchings, Robert W. Perkins, Albert Warner, Harry M. Warner and Jack L. Warner.

Information Concerning Directors.

<u>Name</u>	<u>Principal Occupation</u>	<u>First Became Director</u>	<u>Securities Beneficially Owned at December 1, 1945*</u>
<i>Nominees</i>			
John E. Bierwirth	President and Trustee of The New York Trust Company	1945	None
William H. Catchings	Producer of radio pro- grams	1925	None
Robert W. Perkins	Vice President, Secretary and General Counsel	1936	500 shares Common Stock
Robert Warner	Vice President and Treasurer	1923	210,000 shares Common Stock
Harry M. Warner	President	1923	150,000 shares Common Stock
Jack L. Warner	Vice President	1923	208,800 shares Common Stock
<i>Other Directors</i>			
Muel Carlisle	Controller and Assistant Treasurer	1934	None
Walter P. Friedman	Vice President	1931	600 shares Common Stock
Charles S. Guggenheimer.....	Member of the firm of Guggenheimer & Untermeyer, Attorneys	1932	None
Muel Schneider	Vice President	1944	None
Horris Wolf	Member of the firm of Wolf, Block, Schorr & Solis-Cohen, Attorneys	1928	1,617 shares Common Stock

*Based on information furnished by the respective directors.

All of the nominees, except John E. Bierwirth, have previously been elected Directors of the Corporation by stockholders. For several years prior to 1941, Mr. Bierwirth was a Vice President of The New York Trust Company, and since 1941 has been its President. Mr. Bierwirth was elected a Director of Warner Bros. Pictures, Inc. at a meeting of the Board of Directors on November 23, 1945.

Remuneration of Directors and Officers.

The aggregate remuneration, including fixed amounts paid as allowance for expenses (other than travelling expenses), paid by the Corporation and its subsidiaries, directly or indirectly, during the fiscal year ending August 31, 1945, to directors and to persons nominated for election as directors, and to officers of the Corporation

(as defined in Regulation X-14) receiving payments of remuneration totalling more than \$20,000 during such year, and the excess of such remuneration over that paid during the preceding fiscal year in cases where the remuneration is more than \$20,000, are given below. The fiscal year ending August 31, 1945 included 52 weekly pay days as compared with 53 weekly pay days during the preceding fiscal year.

	Aggregate Remuneration	Excess
Joseph Bernhard*	\$157,100	\$ —
John E. Bierwirth.....	None	—
Samuel Carlisle	48,200	3,450
Waddill Catchings	1,100	—
Stanleigh P. Friedman.....	66,000	—
Charles S. Guggenheimer....	1,100	—
Robert W. Perkins.....	66,000	—
Samuel Schneider	78,900	—
Herman Starr	71,200	4,950
Albert Warner	104,900	—
Harry M. Warner	182,500	—
Jack L. Warner	182,100	—
Morris Wolf	900	—

The firm of Friedman & Bareford, of which Stanleigh P. Friedman is a member, was paid the sum of \$3,900 for legal services.

The firm of Guggenheimer & Untermeyer, of which Charles S. Guggenheimer is a member, was paid the sum of \$10,000 for legal services.

The firm of Wolf, Block, Schorr & Solis-Cohen (Philadelphia), of which Morris Wolf is a member, was paid the sum of \$21,000 for legal services.

The aggregate remuneration, including fixed amounts paid as allowance for expenses (other than travelling expenses), paid by the Corporation and its subsidiaries during the last fiscal year to the directors and officers of Warner Bros. Pictures, Inc., considered as a group, amounted to \$960,000, excluding \$34,900 paid to the aforementioned legal firms.

*Joseph Bernhard resigned as officer and director on September 10, 1945.

Transactions Between the Corporation and Directors.

On September 28, 1945 this Corporation entered into an agreement with United States Pictures, Inc., of which Joseph Bernhard is President and owner of 50% of the stock, for the production of six feature motion pictures for distribution by this Corporation. Warner Bros. Pictures, Inc. does not own any of the capital stock of United States Pictures, Inc. The agreement provides generally as follows. The motion pictures are to be produced at the studios of this Corporation and this Corporation agrees to advance 50% of the cost of production of each motion picture by either cash, charges for talent and facilities furnished for the production of the motion pictures, or proportional charges for overhead of studios, etc. Subsidiaries of this Corporation will distribute the pictures throughout the world and retain from the gross proceeds certain direct expenses and certain percentages of the gross receipts of distribution which vary for different countries. United States Pictures, Inc. is required to provide the other 50% of the cost of production of each of the motion pictures, and may borrow this and pledge as security therefor the negatives, positive prints and all of the net proceeds of distribution after the deductions above referred to.

On November 2, 1945 a loan agreement was entered into between The New York Trust Company, as lender, United States Pictures, Inc., as borrower, and this Corporation, for such part of the cost of production as may

be borrowed by United States Pictures, Inc., which agreement provides for the pledge of the security referred to in the preceding paragraph. After such loans shall have been repaid and Warner Bros. Pictures, Inc. has been reimbursed for the amounts advanced by it, and then United States Pictures, Inc. has been reimbursed for the balance of the amounts advanced by it, then Warner Bros. Pictures, Inc. and United States Pictures, Inc. shall share equally in the remaining net proceeds of distribution.

Appendix B.

WAIVER OF NOTICE

We, the undersigned, being members of the Board of Directors of Warner Bros. Pictures, Inc. do hereby waive all notice whatsoever, of the Special meeting of the Board of Directors of said Corporation, and do consent that the 25th day of September 1945, at 10:00 o'clock in the forenoon, be and hereby is fixed as the time, and 321 West 44th Street, New York, N. Y. as the place for holding the same, and that all such business may be transacted thereat as may lawfully come before said meeting.

(SGD) H. M. WARNER

(SGD) J. L. WARNER

(SGD) ALBERT WARNER

(SGD) S. CARLISLE

(SGD) STANLEIGH P. FRIEDMAN

(SGD) R. W. PERKINS

(SGD) S. SCHNEIDER

(SGD) WADDILL CATCHINGS

(SGD) CHAS. S. GUGGENHEIMER

(SGD) MORRIS WOLF

MINUTES OF A SPECIAL MEETING
of the
BOARD OF DIRECTORS
of
WARNER BROS. PICTURES, INC.

A special meeting of the Board of Directors of Warner Bros. Pictures, Inc. was held at the office of the Corporation, 321 West 44th Street, New York, N. Y., on the 25th day of September, 1945, at 10:00 o'clock in the forenoon.

There were present: Messrs. A. WARNER
S. CARLISLE
S. P. FRIEDMAN
R. W. PERKINS
WADDILL CATCHINGS
C. S. GUGGENHEIMER

constituting a quorum, and Messrs W. S. McDonald, L. J. Goffman, and E. K. Hessberg.

Mr. Albert Warner presided as Chairman, and Mr. E. K. Hessberg, Assistant Secretary, acted as Secretary of the Meeting.

* * * * *

The Chairman announced that Mr. Joseph Bernhard has resigned as Vice-President and Director of the Corporation.

Upon motion duly made, seconded and carried, it was unanimously

“RESOLVED: That the officers of the Corporation be authorized to terminate the employment agree-

ment of Joseph Bernhard with the mutual consent of Mr. Bernhard and the Corporation, such termination to be effective on November 7, 1945, and that Mr. Bernhard be paid the sum of Seventy-Eight Thousand (\$78,000) Dollars as severance pay, such sum to be payable in twelve (12) monthly instalments commencing on December 1, 1945."

The Chairman reported that Mr. Einfeld who had recently severed relationship with the Company had received severance pay of six (6) months' salary.

There being no further business to come before the meeting, it was, on motion, duly adjourned.

(SGD) E. K. HESSBERG

Assistant Secretary

September 10, 1945

To the Board of Directors of
Warner Bros. Pictures, Inc.

I hereby resign as Vice President and Director of Warner Bros. Pictures, Inc., effective immediately.

Very truly yours,

(SGD) JOS. BERNHARD

Joseph Bernhard

Appendix C.

Plaintiff's Exhibit 1—2 sheets.

Agreement made and entered into this 24th day of October 1941, by and between Warner Bros. Pictures, Inc., a Delaware corporation, having its principal business office in the City of New York State of New York, hereinafter for convenience called "First Party," party of the first part and Joseph Bernhard, of the City of New York, hereinafter for convenience called "Second Party," party of the second part,

Witnessesth:

Whereas, First Party is desirous of continuing the sole and exclusive services of the Second Party, now in the employ of the First Party, upon the terms and conditions hereinafter stated,

Now, Therefore, for and in consideration of the sum of One Dollar (\$1.00) in hand paid by First Party to Second Party, receipt whereof is hereby acknowledged, and in further consideration of the covenants and agreements hereinafter set forth, to be performed and kept by the respective parties hereto, it is agreed as follows:

1. First Party hereby employs Second Party and Second Party hereby engages his sole and exclusive services to First Party as a Managing Executive with headquarters in New York.

2. The term of this contract will be five (5) years commencing November 1, 1941 and ending October 31, 1946, and the compensation to be paid by First Party to Second Party for Second Party's services hereunder shall be as follows: Twenty Five Hundred Dollars (\$2,500) per week, plus Five Hundred Dollars (\$500.00) per week as expenses for entertainment. This shall not cover expenses while travelling.

In the event that the Second Party shall be physically or mentally incapacitated from performing his duties hereunder, and such incapacity shall continue for a period of sixteen weeks (16) weeks or longer, First Party shall have the right, at its option, to terminate employment of Second Party under this agreement.

This contract, on its effective date, shall supersede the existing contract between the parties dated March 13, 1939.

In Witness Whereof, First Party has caused these presents to be signed by its duly authorized officer and its corporate seal to be hereunto fixed and Second Party has hereunto set his hand and seal all on the day and year first above written.

WARNER BROS. PICTURES, INC.

By (signed) H. M. WARNER

President

(signed) JOSEPH BERNHARD

Attest:

R. W. PERKINS, Secretary

The parties to the above agreement dated the 24th day of October, 1941, hereby agree that said agreement shall be terminated on November 7, 1945, and thenceforth be of no further force and effect.

Signed in the City of New York this 1st day of October, 1945.

WARNER BROS. PICTURES, INC.

By: (signed) STANLEIGH P. FRIEDMAN

Vice President

(signed) JOS. BERNHARD

Attest:

(signed) R. W. PERKINS

Secretary

Appendix D.

WAIVER OF NOTICE

We, the undersigned, being members of the Board of Directors of Warner Bros. Pictures, Inc. do hereby waive all notice whatsoever, of the Special meeting of the Board of Directors of said Corporation, and do consent that the 28th day of Sept. 1945, at 10:00 o'clock in the forenoon, be and hereby is fixed as the time, and 321 West 44th Street, New York, N. Y. as the place for holding the same, and that all such business may be transacted thereat as may lawfully come before said meeting.

(SGD) H. M. WARNER

(SGD) J. L. WARNER

(SGD) ALBERT WARNER

(SGD) S. CARLISLE

(SGD) STANLEIGH P. FRIEDMAN

(SGD) R. W. PERKINS

(SGD) S. SCHNEIDER

(SGD) WADDILL CATCHINGS

(SGD) CHAS. S. GUGGENHEIMER

(SGD) MORRIS WOLF

MINUTES OF A SPECIAL MEETING of the

BOARD OF DIRECTORS of

WARNER BROS. PICTURES, INC.

A special meeting of the Board of Directors of Warner Bros. Pictures, Inc. was held at the office of the Corporation, 321 West 44th Street, New York, N. Y., on the 28th day of September, 1945 at 10:00 o'clock in the forenoon.

There were present: Messrs. A. WARNER
S. CARLISLE
S. P. FRIEDMAN
R. W. PERKINS
WADDILL CATCHINGS
C. S. GUGGENHEIMER
MORRIS WOLF

constituting a quorum, and Messrs. W. S. McDonald, L. J. Goffman and E. K. Hessberg.

Mr. A. Warner presided as Chairman, and Mr. E. K. Hessberg, Assistant Secretary, acted as Secretary of the Meeting.

* * * * *

The Chairman presented an agreement dated September 28, 1945 with United States Pictures, Inc. formed by Joseph Bernhard and Milton Sperling. The agreement provided for the distribution by Warner Bros. Pictures Distribution Corporation of films to be produced by United States Pictures, Inc. at this Company's studio in Burbank Cal.

On motion duly made and seconded, it was unanimously
"RESOLVED: That any Vice President of this Corporation be and he hereby is authorized and empowered to execute on behalf of this Corporation, the agreement dated September 28, 1945 with United States Pictures, Inc."

* * * * *

There being no further business to come before the meeting, it was, on motion duly adjourned.

(SGD) E. K. HESSBERG
Assistant Secretary

Appendix E.

Extracts from Exhibit 1, Contract Between Warner and United, Dated September 28, 1945.

at pages 1 and 2:

THIS AGREEMENT, made this 28th day of September, 1945, by and between Warner Bros. Pictures, Inc., a Delaware corporation duly qualified to do and doing business in the State of California, hereinafer called the "Company," and United States Pictures, Inc., also a Delaware corporation duly qualified to do business in the State of California, hereinafter referred to as the "Producer," Witnesseth:

at page 3.

FIRST: Producer agrees to produce six (6) motion picture photoplays during the three-year period immediately succeeding the date hereof, with the understanding that the Producer will use its best efforts in view of various production exigencies, and other factors affecting such activities, to produce two (2) or more motion pictures during each of said three (3) years. * * *

at pages 4-5.

SECOND. * * *

The Company shall contribute to the financing of the pictures in the manner hereinafter provided in this paragraph Second. It is understood that the Company will lend to the Producer, under the remaining provisions of this paragraph Second, fifty per cent (50%) of the total cost of production of the first picture, and the Producer will provide the remaining fifty per cent. As to each of the following five pictures, Producer agrees that it will provide such additional portion, if any, of the financing (over fifty

per cent) as its net corporate surplus will from time to time permit, and the Company agrees to advance to the Producer the balance of the cost of each such picture. The Company expressly agrees that whether the Producer's net corporate surplus will permit it to provide more than fifty per cent of the financing for any picture, and if so how much more, shall be determined by the Producer in its sole discretion, and such determination by the producer shall be conclusive and binding upon the Company. * * *.

at pages 8 and 9.

FOURTH: The actual production of each of the photoplays herein provided for (subject to such arrangements as may be made between the Company and the Producer respecting the stage and other space where production is to be carried on, the time or periods of use thereof, and the particular facilities reasonably required by the Producer) shall be within the *exclusive control of the Producer*, including subject matter, selection of stories, preparation of screen play, selection of director, producer, cast, cutting and editing, and the selection of title. Final budget to be prepared by the Producer, for the production of each such photoplay, shall not be subject to the approval of the Company unless such budget shall be in excess of \$850,000.00; if in excess of that sum for any photoplay, such budget shall be submitted to the Company for its approval, and thereupon the Company shall have the right to approve or disapprove of such budget as a whole, but will not withhold its approval as to any separate item or items of any such budget, and further agrees that it will not arbitrarily or unreasonably withhold its approval of such budget as a whole. The fact that the actual production cost of any given photoplay may ex-

ceed the budget thereon as prepared by the Producer, shall not be deemed a default hereunder on the part of the Producer. (Emphasis added.)

at pages 15 and 16.

SEVENTH: (a) * * *

(4½) Out of the gross receipts retained by the Company it shall pay to the Producer, by way of reimbursement, a sum equal to all costs and expenses paid or incurred by the Producer in the production of each of the photoplays herein provided for, which costs of the Producer shall include a *reasonable allowance for its operating and general overhead* in connection with the production of each such photoplay. Such overhead shall include such *reasonable executive salaries* as the Producer shall pay to Joseph Bernhard and Milton Sperling and other production employees; provided, however, that any part of such salaries which may properly be charged to a picture as a direct charge shall not be included in computing the Producer's general overhead. (Emphasis added.)

at pages 23 and 24.

SEVENTH: * * *

(j) After making the deductions authorized under subdivision (a) of this paragraph Seventh, the gross receipts, as herein defined, with respect to each photoplay produced hereunder, shall be retained by the Company to the extent of fifty per cent (50%) thereof, and an amount equivalent to fifty per cent (50%) thereof shall be paid to the Producer at the times and in the manner herein provided. In all cases, the deductions authorized under the provisions of this agreement shall be made and

the percentages above mentioned shall be paid, retained or determined after such authorized deductions have been made from share of the gross receipts hereinbefore provided from each photoplay as same are earned, provided that *if any photoplay shall result in a net loss* then the amount of said loss shall be recouped by the Company from the proceeds of any or all *subsequent photoplay or photoplays*, in addition to the other charges and costs which it is authorized to retain, from such subsequent photoplay or photoplays until it has recouped such loss. If, within four (4) years after the first release in the United States of America of the last photoplay produced hereunder, the Company has not recouped all of the moneys owing to it pursuant to the terms hereof; then the Producer shall pay to the Company the amount of such deficiency. * * *. (Emphasis added.)

at pages 43 and 44.

THIRTY-FIRST: If the Producer shall borrow from any banking association a substantial part of the cost (that is, that part of such cost as the Producer is obligated to pay hereunder) of producing any photoplay herein provided for, the producer shall notify the Company, in writing, to that effect. If any such loan is arranged for by the Producer, the Company having been notified thereof, the Company agrees, notwithstanding any of the preceding provisions of this agreement, that the Producer, may, for the purpose of obtaining and securing the payment of such loan pledge or hypothecate the negative of any such photoplay and execute and deliver to any such lending bank an assignment of moneys accruing from the distribution of any such photoplay in accordance with the customary pledge agreement, chattel mortgage or document of similar import demanded by

such lending bank in connection with the making of said loan. * * *.

at page 46.

If said bank loan shall be made, as aforesaid, then in order that said bank may be reimbursed for the amount of its loan, principal and interest, in accordance with the foregoing, the Company agrees that it will, at the request of the Producer and said lending bank, *subordinate the Company's* right to recoup or be reimbursed for the amount of all production and/or facilities costs and/or moneys advanced by it during the production of each of the photoplays provided for hereunder until the loan made by said lending bank, together with the interest thereon, shall have been fully paid and discharged.

If said bank, as a condition precedent to making said loan to the Producer, shall require a commitment to the effect that any photoplay to be produced hereunder, and financed in part with moneys borrowed from said bank, will *at any and all events be completed*, then, at the request of the Producer and of said bank, the Company agrees that it will, in writing, *guarantee to the said bank* that any such photoplay will be completed, notwithstanding any of the provisions of paragraph Tenth hereof relating to the default of the Producer in producing or completing any such photoplay, which said agreement guaranteeing completion shall include such terms and conditions as shall be agreed upon between the parties hereto, and as said bank may reasonably require, and shall be submitted to the Company for its approval and execution prior to the execution of this agreement if the first photoplay herein provided for shall be financed in part with any such bank loan. (Emphasis added.)

* * * * *

at page 47:

THIRTY-SIXTH: This agreement shall become effective on and after the 7th day of November 1945.

* * * * *

at page 48:

IN WITNESS WHEREOF, the parties hereto have executed this agreement by their respective officers thereunto duly authorized, the day and year first above written.

WARNER BROS. PICTURES, INC.

By /s/ STANLEIGH P. FRIEDMAN

Vice President

Company

UNITED STATES PICTURES, INC.

By /s/ JOSEPH BERNHARD

President

Producer

Appendix F.

Extract from Exhibit 4, contract between Warner and United, dated December 6, 1947.

WARNER BROS.
PICTURES, INC.
WEST COAST STUDIOS
BURBANK, CALIFORNIA

December 6, 1947

United States Pictures, Inc.
c/o Warner Bros. Pictures, Inc.
4000 West Olive Avenue
Burbank, California

Gentlemen:

The following will constitute an agreement between us supplementing and amending certain of the provisions of that certain agreement entered into between us under date of September 28, 1945 and hereinafter referred to as the "basic agreement".

1. Under the provisions of said basic agreement, you agreed to produce *six (6)* motion picture photoplays (hereinafter referred to as the "original photoplays") during the three (3) year period immediately succeeding the date of said basic agreement, which three (3) year period will expire on September 27, 1948. You have heretofore produced three (3) of said six (6) original photoplays. (Emphasis added.)

2. In consideration of the circumstances known to each of us and of our mutual consent thereto, it is hereby

agreed between us that the three (3) year term above referred to shall be deemed extended until January 1, 1951, and said period, as so extended, shall be hereinafter referred to as the "extended term." (Emphasis added.)

3. You hereby agree that the said remaining unproduced original photoplays will be produced during the extended term, and it is specifically agreed that you will use your best efforts to complete the production of one (1) of such remaining unproduced original photoplays during each of the calendar years of 1948, 1949 and 1950.

4. In addition to the three (3) remaining original photoplays, you hereby agree to produce, within said extended term, four (4) additional photoplays, hereinafter referred to as the "additional photoplays", and which said additional photoplays shall be produced under all of the terms and conditions provided for in the basic agreement and applicable to the remaining original photoplays, except as modified hereby or inconsistent with the provisions hereof. To the end that the production periods for each of the four (4) additional photoplays shall be spaced as evenly as possible within the extended term, the period of time between the date of this agreement and the expiration of the extended term shall be considered as divided into four (4) equal periods, and you agree to use your best efforts to produce not less than one of the four (4) additional photoplays in each of such four (4) periods.

5. You agree that, prior to the commencement of the *principal photography* of any of the photoplays herein-

before referred to and about to be produced by you, you will advise us in writing whether the same shall be a remaining original photoplay or an additional photoplay, as hereinbefore referred to. (Emphasis added.)

6. It is agreed that, with respect to the additional photoplays only, we will advance to you by way of cash or facilities (as referred to in paragraph 2 of the Basic Agreement) *one hundred per cent (100%)* of the total cost of the production of each of said additional photoplays, and for this purpose the provisions set forth in paragraph 2 and elsewhere in the Basic Agreement shall be deemed modified with respect to said additional photoplays, but only to the extent necessary to effectuate the foregoing purpose. In this connection, it is agreed that *you shall not be required to expend out of your own funds any portion of the cost of financing the production of said additional photoplays.* It is further agreed that *you shall have the right to apportion, in the manner heretofore practiced by you, your annual studio operating expenses or overhead and to charge the same proportionately to the additional photoplay or photoplays produced in each respective year of said extended term as an indirect cost of said photoplay or photoplays, except that the producer's salary paid by you to the producer of any said additional photoplay shall be charged as an item of direct cost thereof. Our obligations to advance cash or facilities, as above referred to, shall include and extend to such indirect cost.* (Emphasis added.)

* * * * *

11. We shall not be entitled to the recoupment or repayment of any moneys advanced by us in connection with any additional photoplay except only out of the proceeds from the distribution of said photoplay. Accordingly, *if there is any net loss* in connection with any additional photoplay, we shall *not* be entitled to recoup such loss from the proceeds of any *subsequent or prior additional photoplay or original photoplay*, and, moreover, *you shall not at any time be obligated to pay to us the amount of such deficiency or any part thereof.* (Emphasis added.)

* * * * *

Yours very truly,

WARNER BROS. PICTURES, INC.

By /s/ R. J. OBRINGER

Assistant Secretary

Approved and accepted:

UNITED STATES PICTURES, INC.

By /s/ MILTON SPERLING

Its President

Appendix G.

WARNER BROS. PICTURES, INC.

WEST COAST STUDIOS.

Burbank, California.

August 12, 1952.

Schedule H

United States Pictures, Inc.

c/o Warner Bros. Pictures, Inc.

4000 West Olive Avenue

Burbank, California

Gentlemen:

With reference to that certain agreement between us dated September 28, 1945, as heretofore modified, amended and/or extended (all hereinafter referred to as "Production Agreement"), this will confirm the following further understanding and agreement between us with respect thereto.

As of the date hereof there remain to be produced by you under said Production Agreement three (3) original photoplays and two (2) additional photoplays.

It is mutually desired that you produce for our distribution under said Production Agreement *two (2) further* additional photoplays, upon the same terms and conditions as in said Production Agreement set forth and which are applicable to the remaining two (2) additional photoplays to be produced thereunder as above referred to, and you hereby agree so to do. In order to accomplish the production of the photoplays to be produced by you under said Production Agreement, as amended hereby, additional time will be required. Therefore, in consideration of the mutual promises and agreements of each of

us, it is hereby agreed that the term of said Production Agreement shall be extended, subject to the terms and conditions in said Production Agreement contained, to January 1, 1956.

Except as above specifically set forth, said Production Agreement, as heretofore and hereby amended, shall not be deemed otherwise changed, altered, modified or affected in any manner or particular whatsoever.

If the foregoing is in accordance with your understanding of our arrangements, kindly indicate your approval and acceptance thereof in the space hereinbelow provided.

Yours very truly,

WARNER BROS. PICTURES, INC.

By R. J. OBRINGER

Assistant Secretary

Approved And Accepted:

UNITED STATES PICTURES, INC.

By MILTON SPERLING

Its President

No. 14334

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CHARLES B. SMITH, as Special Administrator of the
Estate of EDWARD S. BIRN, Deceased,

Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARN-
ER, UNITED STATES PICTURES, INC. and WARNER
BROS. PICTURES, INC.,

Appellees.

Brief of Appellees, Harry M. Warner, Jack L. Warner
and Warner Bros. Pictures, Inc.

RALPH E. LEWIS,
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650 South Spring Street,
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Warner, Jack L. Warner and Warner
Bros. Pictures Inc.*

FRESTON & FILES,
Of Counsel.

FILED

JAN 29 1955

PAUL P. O'BRIEN,
CLERK

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UNITED STATES PICTURES, INC. and WARNER
BROS. PICTURES, INC.,

Appellees.

Brief of Appellees, Harry M. Warner, Jack L. Warner
and Warner Bros. Pictures, Inc.

Statement of the Case.

This is a stockholder's derivative suit in which Warner Bros. Pictures, Inc., a Delaware corporation, is the corporation for the ostensible benefit of which the action was brought. At the time of trial the District Court directed that the parties proceed first on the questions of the jurisdiction of the Court and the application of the statutes of limitation. The bar of the statutes of limitation had been pleaded in defense [Tr. pp. 20-26] in addition to general denials.

Extensive evidence was then produced by both sides in turn, both in the form of deposition and by way of testimony of actual witnesses before the Court. Upon close of the evidence, defendants moved for dismissal on the ground that the Court had no jurisdiction and for judgment on the ground that the three year statutes of limitation of California and Delaware constituted a bar. The Trial Court wrote a detailed opinion (117 Fed. Supp. pp. 781-812) which contains much valuable discussion of authority and a full consideration of the factors of law herein involved. It dismissed the first cause of action for lack of jurisdiction and the second cause of action for lack of equity, but felt it unnecessary under such rulings to pass upon the matter of limitation. The argument and authorities presented in this brief do not attempt to duplicate the discussion in the opinion of the District Court.

Discussion of the facts in detail, and with references to the record, will be presented where relevant during the argument but the general picture shown by the record and the actual issues herein are not complex. The corporation is a large one and has outstanding in excess of 3,700,000 of its shares, distributed among approximately 30,000 shareholders. The plaintiff owns 400 of those shares. He alleged that the corporation, hereinafter referred to as Warners, was completely dominated and controlled by the three individual brothers Warner, to wit, Harry M. Warner, Jack L. Warner and Albert Warner, of whom, however, only the first two were named as de-

endants. The brothers Warner in the aggregate and together owned approximately fifteen per cent of the outstanding stock. They constituted three of the eleven man Board of Directors and were respectively President and Vice-Presidents.

The alleged evil-doing consisted in the making of a contract between Warners and the other corporate defendant, United States Pictures, Inc., for the production of motion pictures by United with financing and for distribution and exhibition by Warners. This contract was made September 28, 1945. The then stockholders of United were Milton Sperling, a son-in-law of Harry M. Warner, and Joseph Bernhard, whose resignation as a director of Warners had become effective a few days prior to the approval of the contract. Sperling had been a producer of motion pictures for a number of years for another major studio at a generous salary and with great success. He had been released by the other studio (20th Century-Fox) after a military interlude in order that he might be available to render services for United. Some time later Sperling and a trustee for his family became the sole stockholders of United.

The Court found at the end of the trial that Warners was not dominated or controlled by the individual brothers Warner and on the contrary found that the contract in question had been entered into in good faith and without fraud and in the belief of the Board of Directors that it was a sound business arrangement for Warners. It found specifically that neither the stockholders of

Warner nor its officers or directors were at any time antagonistic to the financial interests of the corporation and that neither the corporation nor the directors or officers were shown to be at any time under the domination or control of the three brothers.

The Court ruled that as to the first cause of action United should be realigned with the complaining stockholder and that, when such realignment was made, diversity of citizenship was destroyed and with it the sole basis of jurisdiction of the cause in the federal court. As to the second cause of action, it held that, since United had not been named as a party therein but was so indispensable that the action should not proceed without it, that cause should be and was therefore dismissed for lack of equity.

Summary of Arguments.

It is the position of the appellees, Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, that the conclusions and judgment of the District Court herein as to the propriety and necessity of realignment of the parties with consequent lack of federal jurisdiction are supported by definite and adequate findings of fact and that such findings are amply supported by the record. It is the position of such appellees that, as to the second cause of action, where dismissal occurred for want of equity, the matter was one of discretion and that the discretion of the Court here was properly exercised in the light of the facts. The issues are therefore basically factual, that is to say, whether the findings are so unsupported by the evidence that they must be said to be clearly erroneous and similarly whether the evidence discloses

such a basis that it must be said that the exercise by the Court of its discretion was clearly error and an abuse thereof.

In presenting the argument here, the general arrangement of the appellant will be followed and the questions relating to the first cause of action, and which involve the jurisdiction of the Court as a federal court on the basis of diversity of citizenship, will be first considered. As to this the argument of the appellees may be summarized as an assertion that the realignment of the parties in a derivative suit so as to place the corporation with the complaining stockholder is the general rule, subject to the exception that where improper domination or control by the alleged miscreants are shown such realignment is not made, but that here the findings and the evidence show very clearly that there was no such domination and control and that the general rule and not the exception should apply. As to the second cause of action, it is the contention of appellees that the facts show the controversy involves a contract and its validity; that no final or in fact any determination can be made of the controversy involving that contract without both parties thereto being before the Court; that here, as a matter of his own choice, the plaintiff has not named one of the parties to that contract to be a party to the cause of action, that is to say, United was omitted as a party; and that the nature of the contract and the facts clearly appearing in the record are such that the only proper exercise of discretion was that taken by the Trial Court, to wit, the dismissal of the cause of action for lack of equity.

ARGUMENT.

I.

Diversity of Citizenship Does Not Here Exist and the Realignment Was Proper, Realistic and Required.

The general rule is certainly that in a derivative suit the complaining stockholder and his corporation must be considered as plaintiffs for the purpose of determining citizenship and the jurisdiction which is dependent thereon. This rule is almost a matter of definition in a derivative suit. It is so recognized by appellant though in a negative way and the cases upon which he relies do not hold otherwise. The rule has been developing for three-quarters of a century with a history which has been meticulously traced in the opinion of the District Court herein (*Smith v. Sperling*, 117 Fed. Supp. 781) and which has been reviewed from time to time in the cases as they were progressively decided, such as *Groel v. United Electric Co. of New Jersey*, 132 Fed. 252.

The reason for the rule is clearly recognized. A corporation is itself an entity or artificial person which the complaining stockholder asserts to be under some disability requiring that the stockholder as a self-appointed "next friend" or guardian bring suit on its behalf and for its benefit. Courts have so described the relationship. (*Koster v. (American) Lumbermens Mutual Casualty Company*, 330 U. S. 518 at 522-523; *Illinois Central Railroad Company v. Adams*, 180 U. S. 28 at 34.)

As an exception to the general rule, the corporation is aligned or classified as adversary to the complaining stockholder in those proper cases where the corporation is so completely dominated by the individuals alleged to be miscreants that the corporation has no will of its own

but is practically the *alter ego* of the alleged miscreants. There are such cases and appellant at the outset cites several including *Venner v. Great Northern Railway Company*, 209 U. S. 24, 52 L. Ed. 666; *Doctor v. Harrington*, 196 U. S. 579, 49 L. Ed. 606; *Central Railroad Company of New Jersey v. Mills*, 113 U. S. 249, 28 L. Ed. 949; and *Cutting v. Woodward*, 255 Fed. 633. In the first three of such cases, the realignment was made upon the basis of the bill or complaint, in which circumstances, of course, the allegations in the bill or complaint were accepted as true and at face value, and in the fourth the Court had found the charges to be true.

In *Doctor v. Harrington*, it was alleged that Harrington, the individual defendant, had the voting power of a majority of stock and

“directed the management of the affairs of the corporation, dictated its policy, and selected its directors;”

and that the second corporation involved was “likewise controlled” by Harrington. In *Venner v. Great Northern Railway Company*, *supra*, the individual defendant was the late James J. Hill. The complaint alleged that Hill was a director of the railway company and its president and

“that the railroad and its board of directors were under his absolute control”

and that

“while holding these offices and exercising this control”

he caused the corporation to purchase from him personally owned stock in another railroad at a huge profit to the individual.

In the latter case it was the stockholder urging that his corporation, the railroad, should be aligned with him as the plaintiff so that the case could be remanded to the state court. The defendants were resisting remand after having caused removal in the first place. Appellant appears to assume that the Supreme Court in the *Venner* case was testing the railroad company—as an entity—as to its attitude toward the matter and he also urges that the rationale of this case was the same as *Groel v. United Electric Co.* (Op. Br. pp. 22-24). It is plain from each of these cases that a corporation, being artificial, can have an attitude only through the officers or persons in control and that, if those officers or persons in control are the alleged individual miscreants, then the corporation has no separate mind of its own or any separate attitude of its own and should be regarded precisely as the alleged individual miscreants themselves. In such a case the corporation's attitude to the objects of the action is hostile to the plaintiff and in such cases it will not be aligned with the plaintiff, even though as in the *Venner* case the plaintiff himself wished it to be so aligned.

In *Cutting v. Woodward*, 255 Fed. 633, there had been a trial but the Court had found that a purported sale of assets to the president of the company had been the merest sham, that the president had virtual control of the majority of the Board, that they were always ready to do his bidding and that the circumstances constituted actual and not merely constructive fraud. On appeal the Court found no reason to disturb these findings of fact and they must therefore be assumed to constitute the basis of the decision. In the case now at bar, the situation is completely to the contrary for here the findings are all

the other way and determine that there was no fraud and no domination. As is shown herein, these findings should not be disturbed for they are amply supported by the record and with an opposite factual basis the conclusion is necessarily opposite as well.

In the remaining case cited by appellant on the matter, *Central Railroad Company of New Jersey v. Mills*, 113 U. S. 249, 28 L. Ed. 949, the ruling again was upon the pleadings in removal and remand proceedings and naturally the factual basis was taken to be the fraud and illegality as charged in the complaint.

Appellant then follows with a group of decisions (Op. Br. p. 27) in connection with his general assertion that, if the actions of the president of a corporation are challenged, a court of equity will not invoke the business judgment rule. It is submitted that the cases cited do not establish that a court of equity will "lay aside" the business judgment rule and scrutinize such transactions with a view to determining their legality and fairness. Actually, this is putting the cart before the horse as is evident from the cases cited. In *Pepper v. Litton*, 308 U. S. 295, 84 L. Ed. 281, for example, a one-man corporation was in bankruptcy and the claim of the dominant and controlling stockholder of that one-man corporation was involved. The findings of the Court there, which were amply supported by the facts, showed the clearest kind of fraud. The Court said that the dealings of a dominant or controlling stockholder with his own corporation will be subject to "rigorous scrutiny." Similarly, in *Remillard Brick Company v. Remillard-Dandini Company*, 109 Cal. App. 2d 405, the control described by the Court was complete and the holding was primarily that mere disclosure to the minority, by the dominant power, of an intent to raid or mulct the

corporation, does not automatically put that dominant power in the clear.

Detailed analysis of further authorities in this group would serve no useful purpose. Certainly a scrutiny of a challenged action should be made, and when control or domination is asserted there should be rigorous scrutiny, but such scrutiny is primarily to see if there is control as alleged and, if there is, then to see if the transaction is in the financial interests of the corporation. Here in the case at bar, the matter of domination and control was fully presented by the parties and was subject to rigorous scrutiny, and after such scrutiny the Trial Court found that there was no such objectionable domination but that the Board of Directors had acted independently and in the exercise of good business judgment.

Appellant also uses the word and emphasizes the *attitude* of the corporation (Op. Br. pp. 24 and 29) and this term does appear in *Cutting v. Woodward*, 255 Fed. 633, and also in *Delaware & Hudson Company v. Albany & Susquehanna Railway Company*, 213 U. S. 435, 53 L. Ed. 862, but the question is, more accurately, whether in the language used by the Court herein (but answered in the negative by the Court), the corporation was

“under control antagonistic to the financial interests of said corporation and its stockholders” [Tr. p. 77].

These cases, as leading cases in the field, establish the rule and its reason. In *Groel* and *Venner* and others cited by appellant, the corporation was not realigned under the general rule but remained aligned among the defendants under the exception based upon the matter of control and domination. As noted, in three of these cases there had been no trial of fact on the subject of diversity,

and the domination, which is the critical factor in testing the so-called attitude of the corporation, was taken as pleaded, and in the other the Court had found domination as a fact. In the present case the rules applicable are, of course, the same but there has been a trial of the issue and the Court has found domination did not exist.

The District Court here found [Finding IV, Tr. pp. 74-75] that there were eleven members upon the Board of Warner Bros. Pictures, Inc. The two brothers Warner, that is, Harry M. and Jack L. Warner, are individual defendants named herein. They with their brother Albert were three of such eleven. At the time of the execution of the base contract herein involved, the brothers Warner, as individuals, owned less than twenty per cent of the outstanding stock of the corporation

“and that neither the corporation nor the directors or officers were shown to be at that time or at any time under the domination or control of the three brothers Warner above named.”

It also found in Finding V [Tr. p. 76] that the stockholders of the corporation were not at any time, nor at all, under the domination or control of the three brothers Warner, nor was the Board of Directors dominated or controlled by any of the individual defendants. The District Court concluded [Conclusion II, Tr. pp. 78-79] that the stockholders, directors and officers were not dominated by the brothers Warner, nor any of them, and that the corporation was not and had not been in the hands nor under the control of persons antagonistic to the interest of the corporation in this action.

In the *Venner* and *Groel* cases, for example, the complete and absolute domination and control by the individ-

ual defendants were taken as true merely because the plaintiff so claimed, but here after trial, and as a factual matter, the District Court has found and concluded otherwise, and under Rule 52 of the Rules of Civil Procedure these findings at the trial should not be set aside or disregarded unless they are clearly erroneous. The findings are responsive to the facts, and clear, or any error has not been and cannot be shown. Such Findings are supported by ample direct evidence and by necessary inference from many facts of different kinds as hereafter set forth.

The record shows that the Board of Directors of Warner Bros. Pictures, Inc. consisted of eleven members including the three brothers [Tr. p. 74] and ten of these members, that is, Messrs. Friedman, Perkins, Wolf, Guggenheimer, Catchings, Carlisle, Schneider and J. L., Harry and Albert Warner, were directors at all times relevant here. The eleventh man prior to September 25, 1945, had been Joseph Bernhard. Between that date and November 23, 1945, that particular office was vacant and since that time the remaining member has been John Bierwirth [Stp. of Facts. Tr. p. 27].

The testimony of most of these persons on the subject of influence, domination or control appears in the record. Appellant (Op. Br. pp. 31-32) argues that the Board and the corporation were controlled by or under the "working control" of the three brothers Warner and such assertion seems to be based on inference from the facts that four members of the Board were lawyers employed by or on retainer to the corporation and two were salaried employees of the corporation (Op. Br. pp. 8-9) and that their re-election as directors might be prevented. Appellant cites the salaries and retainers paid (Op. Br. p. 8)

from which it appears that the purely venal standard of money received as salary or retainer is being applied, and that in so doing appellant does not distinguish between control or domination on the one side and reliance by directors on information and recommendations made by persons known to the Board as highly capable executives who had demonstrated their abilities by many years of success in their respective fields, even though such executives were the brothers Warner.

The Court found that the three Warners held less than twenty per cent of the outstanding stock of the corporation [Tr. p. 75] and the Stipulation of Facts [Tr. p. 28] showed that actually, at all relevant times, they owned approximately fifteen per cent between them. There were outstanding 3,701,090 shares [Tr. pp. 27-28] which were held by an aggregate of about 30,000 shareholders [Tr. p. 120]. Appellant states as a fact (Op. Br. p. 3) that the brothers Warner had a "working control of the company" but clearly on the facts no such control of either the stockholders or the Board of Directors could be legitimately inferred as a result of ownership by them of shares of stock in the corporation. The members of the Board of Directors are elected by the stockholders at annual meetings, each director being elected for a two year term after nomination by the Board; five directors being elected in one year and six in the next [Tr. p. 305; and Op. Br., Appendix A, p. 2]. A proxy committee solicited proxies from shareholders to be voted for the nominees of the Board (see proxy statement, Op. Br., Appendix A, p. 2).

The basic agreement between the corporation and United States Pictures was presented to the Board and approved

by it at a meeting held September 28, 1945, at which meeting there were seven members present, that is, Messrs. Albert Warner, Carlisle, Friedman, Perkins, Catchings, Guggenheimer and Wolf (Op. Br., Appendix D, p. 13). On that date there was one vacancy on the Board as already noted and the absent directors were J. L. and Harry Warner. It might be remembered in this connection that absent directors cannot vote by proxy (*cf. Lippman v. Kehoe Stenograph Co.*, 11 Del. Ch. 80, 95 Atl. 895) and cannot delegate their duties or assign their powers. Each of the directors present, as well as those who were present at meetings though not members of the Board, gave direct testimony as to the situation. Appellant has, in addition to pointing out the amounts received by a number of these persons from the corporation, but in each case in a capacity other than as a director (Op. Br. p. 8), indicated (Op. Br. p. 9) that Harry Warner had influence with them. The extent and character of any such influence as shown by the testimony noted by appellant, however, does not show control or domination with respect to this or any particular situation or question, nor even as a general matter. Nevertheless, from such testimony appellant infers a general influence and then, on such basis, infers specific influence and domination. The Trial Court did not draw any such inference but found, as noted, that the Board was not controlled and dominated by the three brothers Warner.

One of the directors, Waddill Catchings, testified that he was legally trained and had been with Sullivan & Cromwell [Tr. p. 243] and later had been associated with financial interests such as J. P. Morgan & Company and Goldman, Sachs & Company [Tr. p. 244]. He had gone on the Board of Warner Bros. as a representative

of the owners of stock underwritten by his firm. He was still a director of a considerable number of large corporations such as Chrysler Corporation, Sears, Roebuck, etc. [Tr. p. 245]. He had no connection with Warner Bros. except as a director for which he received a fee of \$50.00 per meeting [Tr. p. 246]. He had been at the meeting of September 25, 1945, and the meeting of September 28, 1945. He had voted each time and no one at that time or in connection with such matters had told him how he should vote, but he had voted in the exercise of his own independent judgment [Tr. pp. 247-248-249], and considered the contract to be a good contract from a business point of view. This was also the case with respect to an amendment of the contract in 1946 [Tr. p. 254] and also in 1950 [Tr. p. 257]. He was aware that Milton Sperling was a son-in-law of Harry Warner and that [Tr. pp. 258-259]:

“I couldn’t fail to give consideration to the fact; but it certainly did not influence my voting in favor of any of the contracts.”

On cross-examination, he stated his opinion [Tr. p. 261] that

“I have never felt that the Warner brothers were dictating to me as a member of the Board as to what names to submit to the stockholders”

with respect to the nomination of candidates for the office of director, but that

“the Warner brothers express their opinion, and anybody else that has any opinion is entitled to express it * * *.”

When asked in cross-examination whether it would be an unfair statement to say that, if the Warner brothers

so desired, a person would be kept off the list of candidates, he testified that he would not so state and that it was a matter of pure speculation what would happen if there should be a difference of opinion between the Warner brothers and those who were not connected with the company or the family, and that he had never seen any indication of any attempt to force any candidate on the Board by Harry Warner [Tr. pp. 262-263]. The Warners had never had open and shut control and that in the past, if he had come into conflict with the Warners, he might have been able to push the Warners around [Tr. p. 264]. In his opinion, Bierwirth, Guggenheimer and Wolf were certainly independent. On the specific contract, it had been recommended by Harry and Jack Warner, and he placed great faith in the recommendations from those in charge on the Coast [Tr. p. 268].

C. S. Guggenheimer testified he was a practicing attorney and had been a director of many corporations. His firm was under retainer from the corporation but Warner Bros. was not its principal client [Tr. pp. 270-271]. At the meetings here relevant he had definitely used his own independent judgment [Tr. p. 273] and no one had stated directly or indirectly how he should vote [Tr. pp. 275-276] and that, with respect to the United States Pictures deal, definitely no person made any suggestions, requests or directions as to how he should vote on any of the matters [Tr. p. 278]. He did not remember that Albert Warner, who presided at the meeting, had ever actually made any recommendations [Tr. p. 282]. He personally represented 200,000 shares at one time and still represented 50,000 or 60,000 shares and was on the Board for that reason [Tr. p. 284] but that, unless his clients wanted him to battle with the

Warners, he would probably not try to remain a Board member if the Warners did not want him on the Board [Tr. pp. 284-285].

Morris Wolf was also a practicing lawyer in Philadelphia, had been a director for many years and was at these meetings. He was not told or instructed by anyone how to vote [Tr. pp. 287-288]. In fact, there were no suggestions or instructions by anyone [Tr. pp. 289-290]. He did not think he could be elected to the Board if the Warner brothers opposed it and, in fact, if anyone in authority indicated the services of his firm were not required, he would acquiesce [Tr. pp. 291-292].

Most of the other directors testified to much the same situation and indicated quite positively that so far as the particular witness was concerned his action on the Board, and certainly in connection with the United contract, was quite independent, was in the exercise of his best judgment and that he had been given no directions or requests or orders of any kind as to how he could vote or what attitude he should take [*e. g.*, see Carlisle, Tr. pp. 177, 182, 187, 188; and Perkins, Tr. pp. 297, 298, 300, 304; Albert Warner, Tr. pp. 237, 239, 240; McDonald, Tr. p. 224; also *infra* this brief].

Appellant (Op. Br. pp. 8-9) himself presents references to the evidence from which he, but not the District Court, infers that these directors were subject to domination and control. The inference is based upon the fact that Friedman, Perkins, Carlisle and Schneider were employees of the corporation at substantial salaries and that Wolf and Guggenheimer were respectively members of legal firms in Philadelphia and New York which received retainers from the corporation in the year 1945 for pro-

fessional services. However, as noted herein, Guggenheimer's other testimony negated any inference of domination merely from the receipt by his firm of a small retainer and the same was true of Mr. Wolf. Moreover, the testimony of Wolf that he would acquiesce if anybody in authority in the corporation indicated that his services were not desired any more, very clearly referred to his services as a lawyer or the services as his firm in a professional capacity and had no reference to his specific capacity as a director [Tr. pp. 291-292].

Messrs. Perkins and Friedman testified at length, the former by deposition and the latter in person. Perkins, whose compensation was received in his capacity as Vice-President and General Counsel of the corporation, on cross-examination testified that as a director he was elected for two years by the stockholders and that he was nominated as a candidate for the Board by the Board itself. The Warners had considerable influence with the Board [Tr. p. 305]. He was then asked specifically if, at the end of a term of office the three brothers Warner desired to see to it that the witness was not nominated for the ensuing term, the brothers Warner could succeed in their desires and keep him off the slate. His reply was that he did not know, but whether he would himself be a candidate was different and that he did not believe he would run as a candidate [Tr. pp. 305-306].

Mr. Friedman testified that he was a Vice-President of the corporation as well as a member of its legal department at the home office [Tr. pp. 444-445]. When asked concerning the procedure of the Board with respect to the nomination of its members, he stated unequivocally that Harry Warner did not control the naming of such candidates for the Board of Directors [Tr. p. 487]. He

was asked whether the three brothers Warner controlled his continuance in office as an attorney and he stated that [Tr. p. 490] if, as an attorney, he became *persona non grata* to any of the Warners or any other executive of the corporation he would feel that his professional services were no longer required and he would resign as an attorney. So far as the brothers Warner were concerned, this was not because they were the holders of any proportion of the stock but because they were the chief executive officers.

The actual testimony as to what Messrs. Perkins and Friedman said with respect to resignations is substantially different in meaning and effect from that indicated by appellant (Op. Br. p. 9), because the testimony refers only to their professional capacity as employed attorneys and does not refer, nor is there any mention of any such action, to resignation in connection with their capacity as directors. Mr. Friedman also testified that he did not consider that the brothers Warner had control, either actual control or working control [Tr. pp. 490-491]. He regarded the ownership of fifteen per cent of the stock as a nucleus to which other stock could be attracted by proxy and that that was the extent by which the brothers Warner had any advantage over any other stockholder [Tr. p. 491]. He testified also, and we submit that it is a fair analysis [Tr. pp. 491-492], that the brothers Warner had been executive officers of the corporation from its inception, had brought the corporation through many serious vicissitudes and had done well for the corporation and that as a result of such abilities, and with their fifteen per cent stock ownership as a nucleus, they could obtain the vote of many stockholders by proxy for the reelection

of directors. Their opinions as executives were much valued and, by virtue of such past history and their success over the years in management of the corporation, the brothers Warner might be said to control the basic policies of the company but not because of any ownership of any particular stock [Tr. pp. 492-493]. With respect to the United contract and the meeting at which it was adopted, Albert Warner had indicated to the Board that he believed the United agreement would be an agreement to the advantage of the corporation and recommended its adoption. He did not think that Albert Warner had said that Albert, Harry and Jack would like to see the Board adopt or approve the contract but merely that the brothers Warner wished the contract to be submitted to the Board for its consideration and that Albert recommended its adoption [Tr. p. 493].

The testimony of the directors, singly or together, as to the status, behavior and influence of the brothers Warner is very similar to that considered in *Solamine v. Hollander*, 128 N. J. Eq. 228, 16 A. 2d 202. The opinion is very comprehensive, but as its last point (16 A. 2d at 246) the Court said:

“It is claimed that the Board of the Hollander Company has been dominated by the three Hollanders. Unless that fact is to be inferred from the mere circumstance that the three Hollanders were the chief developers of the company’s business, are the seniors in point of service, and are men of wide experience in their industry, as shown by the testimony, there is no evidence to support the charge. * * * It is easily understood that his (M. Hollander) position and personality have made him a commanding figure in his company, and that his fellow officers and

directors respect his business judgment. This however does not spell out that domination which the cases deem objectionable. There does not appear in the evidence a single instance where any or the three Hollanders imposed their will against the judgment of their co-directors."

In conclusion upon this matter of domination, the testimony already noted is also persuasive from a slightly different aspect. The brothers Warner had about fifteen per cent of the stock of the corporation. Their personal experience and success attracted the participation of other stockholders, though the record does not show how many or what percentage of shares of other stockholders was given by proxy to the brothers Warner at any given annual election. However, the members of the Board were elected for two years. It is elementary that a director can be removed only by the stockholders and not by his co-members on the Board. It seems obvious that it would be quite a different thing to attract and secure proxies of enough stockholders to cause the removal of one or more directors as a special and punitive step than to secure a sufficient number to elect one or more directors at an ordinary routine annual meeting. The members of the Board who testified as above did not say that they would resign as directors, even when they were among those referred to by appellant as the "inside" directors. As directors no real threat or pressure could be put upon them under the circumstances except through the application of the venal standard suggested by the appellant. There is, of course, in the record nothing to indicate that any of the directors were other than men of personal strength and integrity who would not be controlled on any such basis, nor that there was

a single instance shown in which such intergrity and independence had in fact been surrender.

We submit that, on the record, it is perfectly clear that the realignment made by the Court was proper and required, and that there was no diversity of citizenship and hence no jurisdiction in the Court as a federal court as to the first cause of action.

II.

Dismissal of the Second Cause of Action by the Court Was a Proper Exercise of Discretion.

The District Court herein dismissed the second cause of action for lack of equity because United was not named (neither was Sperling) in such cause of action but was in the Court's opinion a party which ought to have been joined [Tr. pp. 78-79; Op. 117 Fed. Supp. 810]. Appellant in this respect argues (Op. Br. p. 33 *et seq*) that a court of equity should go as far as it can in granting relief and should not withhold its power merely because complete relief cannot be accorded. He asserts (Op. Br. p. 33) that this cause of action obviously sought no more than that Harry and Jack Warner be adjudicated as guilty of a breach of trust and be ordered to respond in damages for their asserted misconduct, and that it sought nothing whatever from United as the omitted party.

Under appellant's description, his second cause of action merely requests a money judgment against two individuals with no other relief possible or requested which would be essential to such a judgment. If this were the situation, there would be no reason for the exercise of any of the special powers of an equity court, though the argument of appellant is based upon the idea that the Trial Court was a court of equity and "will strain hard" (Op. Br.

p. 37) to determine the merits. The District Court herein is concerned not only with its jurisdiction as a federal court but also with the quite distinct questions involved in the included but separate jurisdiction as a court of equity (*Tucker v. National Linen Service Corporation*, 200 F. 2d 858 at 863). In a case where the only possible relief requested could be given in a court of law, *i. e.*, a money judgment alone, the jurisdiction of equity is merely concurrent, and its aim should be to see that its forum is not abused.

Here, United is before the Court and was before the Trial Court under the first cause of action. There was no question of difficulty or inconvenience in finding or serving a party but appellant, as plaintiff, of his own choice omitted this party as well as Sperling in the second cause of action. We submit a court of equity will not strain very much under such circumstances. It cannot be so forced by the voluntary act of a plaintiff. On the contrary, he who seeks equity must do equity and in any such case, as is said in *Koster v. Lumbermens Mutual Casualty Company*, 330 U. S. 518 at 522, 91 L. Ed. 1067 at 1072, the Court,

“will be alert to see that its peculiar remedial process is in no way abused.”

Furthermore, appellant's description of his second cause of action is at variance with his pleading, both as to the actual allegations of the second cause of action and the prayer of the complaint. It further disregards the facts shown by the record which are relevant to the exercise by the court of its discretion as a court of equity and under Rule 19, F. R. C. P.

Appellant correctly notes that with respect to the second cause of action there was diversity and hence federal

jurisdiction, the actual action of the court being an exercise of discretion within that jurisdiction. It was also a denial that the facts gave it jurisdiction to proceed as a court of equity. Appellant cites *Young v. Powell*, 179 F. 2d 147, and includes a quotation (Op. Br. p. 36) which was in turn a quotation by the Court from *Hudson v. Newell*, 172 F. 2d 850. The portion quoted sets forth certain "fundamental principles" which are undisputed and in fact largely paraphrase Rule 19, but those principles were not applied in the *Young* case and cannot be here applied with the effect appellant desires.

In *Young v. Powell* the action was by one residuary legatee against another residuary legatee to set aside certain gifts and cancel an instrument. Other residuary legatees were not named as parties. The Trial Court had refused to dismiss on the ground that the other legatees were not parties and had in fact granted relief which happened to be beneficial to the omitted parties. The Court of Appeal (5 Cir.) very definitely rejected this as a factor and dismissed the action for absence of parties, indicating that it was the relief *asked* which was the guide to determining the dispensability of parties and that otherwise Rule 19 would be a "delusion and a snare."

Here the second cause of action repleads all of the allegations of the first cause [Tr. p. 11] except Paragraph 11 of such first cause, which asserted a conspiracy among the individual defendants. Among the allegations so repleaded, the appellant asserted in Paragraph 25 that he had no adequate remedy at law and that there would be,

"irreparable damage unless the relief requested herein be granted."

The relief requested consists of five items [Tr. p. 15] of which the fourth is costs and fees of the plaintiff and the fifth is merely for general relief. Item one asks an accounting for losses and damages suffered by Warner and for all profits and benefits received by the defendants and that the defendants make restitution. There were in fact no allegation anywhere that the individuals who alone are named in the second cause of action, that is, Harry and Jack Warner, had ever received any profits or benefits or anything else which they could restore. Items two and three prayed that a trust be impressed on the capital stock and assets of United and that the agreement between Warner and United, so far as the same is unexecuted, be cancelled and terminated.

It would certainly appear that appellant in his complaint asserted that the damage would be irreparable unless many things were done. His present argument urges that all he asked for in effect was a money judgment against Harry and Jack Warner. It is submitted that it is the allegations and the prayer of the complaint which are here the guide and not the present assertion of the appellant. This is indicated by the Court in *Young v. Powell*, *supra*, on which appellant relies. It is quite obvious that by far the greater part of the relief requested could not be given in the absence of United and Sperling and that no money judgment against the two individuals named could remedy the "irreparable damage" asserted to exist.

Rule 19(b) provides first that, if a party is omitted who is not indispensable but who ought to be a party and who is available, the Court will order that party brought in if to do so would not destroy jurisdiction. It is true here that United was easily available but to order it brought in as a party would destroy diversity

and hence jurisdiction to the same extent as was the case with the first cause of action. The Court did not order United brought in. The rule then provides that, if there are such parties who ought to be in, but jurisdiction would be destroyed if they were brought in, the Court in its discretion may proceed with the action without such parties and the judgment will not affect the rights of those absent. Here the Court concluded that, while not stating that United was an indispensable party in the absolute sense, it was so necessary and indispensable that a final determination of the cause without United would not be equitable [Tr. pp. 78-79; Op. 117 Fed. Supp. 810]. Under the rule, even if United were not actually indispensable, the Court had discretion to proceed with the case or to dismiss it and it exercised that discretion in favor of dismissal. It is submitted that the basic question is whether that discretion was abused under the circumstances.

As already indicated, there are a number of facts in the record which we submit show very clearly that the dismissal was a proper exercise of discretion. The discrepancy between the actual allegations and the prayer of the complaint, particularly the second cause of action, and the argument thereon and the description thereof by the appellant have already been noted. The record also shows, and appellant asserts, that the contract between Warner and United made in 1945 had been subject to successive amendments and that such agreement as a whole provided for the production of thirteen photoplays of which eight had been made (Op. Br. pp. 16-17). The contract was therefore executory as to five photoplays. The photoplays themselves were divisible into two classes so far as terms were concerned and of the remaining or executory

photoplays, three were so-called original pictures under the 1945 agreement, and two were the so-called additional pictures provided for by the amendments. On the original pictures, Warners agreed to furnish financing to the extent of fifty per cent, to distribute the pictures at a distribution charge of twenty per cent domestic and twenty-five per cent foreign of the gross proceeds and was entitled to fifty per cent of the net proceeds [Op. Br. p. 14; Tr. pp. 525-526]. As to the additional pictures, Warners was to furnish one hundred per cent of the financing, to distribute at a fee of twenty-five per cent domestic and higher abroad, and would be entitled to eighty per cent of the net. Which of the arrangements might be the more beneficial to the corporation is not here relevant, even if it were demonstrable, but the approximate terms and the fact that the unmade pictures, to be produced before January 1, 1956, were substantial in number and might be made under different conditions, are facts in themselves bearing upon the exercise of discretion by the Court. Under the contract any net losses on one picture were to be recouped from profits, if any, on subsequent pictures (Op. Br. p. 17). Further, such contract provided (Op. Br. App. p. 17) that, if there was any deficiency four years after the release of the last photoplay, United would pay the amount of the deficit, so there would be no loss unless United were then insolvent. The query is appropriate, we believe, as to the possibility of any kind of final determination by way of a present money judgment against two individuals under the second cause of action when such an executory contract would be left outstanding under which it could not, at any given time, be told whether there would be profits or losses or whether the venture as a whole would result in profits or losses.

More to the point than *Young v. Powell* are the two cases in this circuit of *Washington v. United States*, 87 F. 2d 421, and *Pioche Mines etc. v. Fidelity Philadelphia Trust Co.*, 202 F. 2d 944. The *Pioche* case, together with *Tucker v. National Linen Service Corporation*, 200 F. 2d 858 (5 Cir.), furnish, we submit, the standards and principles which are here directly applicable.

This Court in *Pioche v. Fidelity*, *supra*, quoting from *Washington v. United States*, sets forth (p. 947) four questions and states that if all four are answered in the affirmative then an absent party is a necessary party, but if *any* of the questions are answered in the negative, then the absent party is indispensable. These questions are (1) Is the interest of the absent party distinct and severable? (2) Can justice be rendered between the parties before the Court? (3) Will such decree have no injurious effect on the interest of the absent party? (4) Will the final determination be consistent with equity and good conscience in the absence of such party?

In *Tucker v. National Linen Service Corporation*, 200 F. 2d 858, it is said that it is perfectly clear that where cancellation, reformation or other equitable relief is asked in respect of a contract, all of those having an interest in the contract or who will be affected by the decree are indispensable parties and must be before the Court (p. 863). The Court then explains

“This is so because, while the absence of indispensable parties as such does not go to the jurisdiction of the Court as a federal court but to its jurisdiction as a court of equity, if federal jurisdiction depends wholly upon diversity of citizenship, such jurisdiction may be maintained or defeated by the presence or absence of indispensable parties, as the case may be. In so far, therefore, as the suit sought the equitable relief

of cancellation and its incident, an accounting, as to certificates of stock now standing in the names of persons who are not, and cannot be made, parties to the suit without destroying diversity jurisdiction, the district judge was clearly right in dismissing the action for want of these indispensable parties."

The four questions in *Pioche v. Fidelity* cannot be answered entirely in the affirmative here and this is plain from the explanation given by the Court in *Tucker v. National Linen Service Corporation*. Certainly the interest in a contract of one party to that contract cannot be different in character from that of the other party to the contract so as to be completely severable and treated as a thing by which that other party will not be affected. Certainly any decree affecting that contract will likewise affect the absent party to that contract and may do so injuriously. The fact that a decree on the merits might be beneficial to the party is immaterial as is evident from *Young v. Powell*. The necessity for affecting the contract between United and Warner by any decree herein is to be tested by the complaint, under the cases above cited, and not by the present description of appellant. Any decree or judgment against the two individual brothers Warner adjudging them guilty of misconduct in promoting the contract relationship between Warners and United and Sperling, such as appellant now says he wanted, must of necessity go to the roots of that contract from its inception and, if the decree against the two Warners were as prayed to the effect that they were so guilty of misconduct, the interests of United would certainly be affected adversely or injuriously thereby. Furthermore, as shown from the facts, there could be no justice or equity in any present money judgment against the individual Warner brothers for asserted damages due to misconduct

in connection with the United action, since the transaction is presently largely executory and there cannot possibly be any determination of any final amount of damages or loss under such circumstances, though as of the time of trial there appeared to be very large overall profits rather than any losses at all [Tr. pp. 528, 529, 552].

The questions propounded in *Washington v. United States*, *supra* and *Pioche v. Fidelity*, *supra*, take as their premise the fact that the party or parties absent from the action must be interested in the controversy. Certainly United and Sperling are interested in the controversy. It is that "interest" which is the subject of the questions then propounded. The controversy certainly involves the validity of the contract between Warners and United. All parties to that contract are certainly interested in that matter of validity and propriety of the contract. The interest of United is directly in the contract, and the interest of Sperling as a stockholder and employee of United also extends to the contract. We again submit that the interests of United and Sperling as the absent parties are not a severable part of the controversy and that it certainly cannot be said that any decree made which will or can affect or establish the validity or invalidity of that contract will not have some effect on the interest of the absent parties.

In *Pioche v. Fidelity*, 202 F. 2d 944 and *supra*, the Court, after putting the questions, answered them as to their application to the facts of that case, which involved a contract between a named party and an absent party. This Court there (p. 948) stated positively that it was unable to see how justice could be rendered between the parties then before the Court since the controversy involved the assertion that the parties had not performed their obligations thereunder and that no order which would

cause performance could be made against the absent party. There is little essential difference here and we submit the same would be true in practically any case in which the subject matter of the controversy is a written agreement between specific parties when only one of such parties to the contract is a party to the action.

In any case it is submitted that the relevant questions cannot all be answered in the negative and hence, as held by this Court in the cases cited, the absent parties are indispensable. If so, the cause had to be dismissed. If they were not indispensable, but should have been present, the Court had discretion.

We have therefore a situation where the District Court had at very least a discretion as to whether to proceed with the second cause of action or to dismiss it. It may have had the obligation to dismiss, and not merely discretion, but there was certainly no obligation to proceed. In the exercise of its discretion, some of the relevant elements have been already discussed. If the trial went forward, only a money judgment could result and that money judgment could not possibly be complete or final in any sense. No fixed amount could be settled which could with any certainty be said to represent any damages or losses so long as it could not be certain that there would be under the contract any loss or damage whatsoever or any indirect loss or damage on the theory of possible profits which might have been obtained had funds not been diverted. There are a substantial number of photoplays yet to be produced. Each one might produce either a profit or loss. If all of them produced a loss, then at the end of the road a sum could be fixed to represent the accumulated loss, but only if United were insolvent and could not itself pay any deficit. However, under

the contract a profitable picture might wipe out all prior losses and create a net profit, and as for all but one of the pictures has been profitable.

We have above described certain possibilities since the possibilities have a direct bearing upon the propriety of the exercise of discretion. However, the facts, as of the time of trial, are even more persuasive in assessing such exercise. Mr. Schneider, a vice-president and director, testified that the ninth picture was then being produced [Tr. p. 527] and that of the eight already produced one showed a loss but seven showed or would show a profit, so that [Tr. pp. 528-529] the corporation would have a net profit of one and one-half million dollars besides collecting five and one-half to six million dollars as distribution charges and a million dollars profit in the theatres owned. Query: Is it an abuse of discretion to decline to proceed with an action for money damages against two individuals when at that time, even before the full testimony on the merits, it is highly probable, if not conclusively apparent, that there were not then and would not later be any damages at all?

As a further factor relevant to the exercise of its discretion by the Court, there is the bar or defense of the statutes of limitation. The applicable statutes of four states were pleaded [Tr. pp. 24-25]. The notice to dismiss at the close of the case rested in this particular on the statutes of California and Delaware [Tr. pp. 588-589]. The Court believed it unnecessary to express any opinion on the matter as a separate issue (117 Fed. Supp. at 812). We believe it plain, however, that the statute of California would govern as the law of the forum; that the relevant section is the three year limitation under Section 388 of the State Code of Civil Procedure since the

matter is essentially one of alleged fraud; that such period of three years under this statute runs from discovery by the aggrieved party; that here the corporation is clearly the aggrieved party under the authorities herein specified. The basic act complained of is the approval and execution of the contract by the corporation on September 28, 1945. This action was not filed until December 15, 1948 [Tr. p. 16] which is more than three years after the act. Clearly, the corporation must be held to have discovered the facts no later than its own approval of the contract on September 28, 1945, and the time would have commenced to run on that date since under the findings the corporation was not then under any disability because of domination. All of these facts relative to the defense were presented by the parties and appear in the record. The action would appear to be barred and, even though the Court as noted did not feel it necessary to express an opinion thereon, nevertheless the existence of the defense and its probable merit are still factors to be considered in testing the exercise of discretion.

In conclusion we submit that the judgment of the Trial Court dismissing each of the causes of action is just and equitable, is realistic and in accordance with the findings which in turn are thoroughly supported by the evidence. It is submitted that the judgment of the Trial Court should be affirmed.

Respectfully submitted,

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Of Counsel.

No. 14334.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CHARLES B. SMITH, as Special Administrator of the
Estate of Edward S. Birn, Deceased.

Appellant,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WAR-
NER, UNITED STATES PICTURES, INC., and WARNER
BROTHERS PICTURES, INC.,

Appellees.

APPELLANT'S REPLY BRIEF.

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Appellees.

APPELLANT'S REPLY BRIEF.

Appellees do not gainsay that stockholder and his corporation, citizens of different states, are on opposite sides of a justiciable controversy, viz.: whether the corporation was used unlawfully to unjustly enrich Harry Warner's family at the company's risk and expense, and to its detriment.

Nor can appellees gainsay, that all who administered the Warner Company's affairs, to a man, viz., the so-called independent undominated directors, as well as the brothers Warner, are hostile and opposed to the objects of the suit; and that it was useless and futile for com-

plainant or any group of stockholders to demand that the corporation seek vindication or institute the suit. [R. pp. 587-588.]

“The Court: As I understand the defendants’ position, and I can be corrected if I am in error, the defendants’ position is that this was an advantageous arrangement to the Warner Corporation, and the directors would have upheld it at any time against any attack by any person, including any group of stockholders.

Mr. Levy: That is the position of both the individual defendants Warner brothers, and the corporation—all of them contend likewise.

Mr. Williams: The individual defendants Warner brothers are not involved in that issue. It is the corporation that is involved in that issue.

The Court: And, for those reasons, no matter what demand the plaintiff stockholder had made on the directors, they would never had brought this suit. Is that a fair statement of it?

Mr. Williams: Yes, that is a fair statement, but not for the reasons alleged in the complaint, that there was domination; but for the reason that in the opinion of the responsible officers and directors of the corporation this was a good contract.

The Court: By ‘good,’ you mean advantageous to the corporation?

Mr. Williams: Advantageous to the Warner corporation, yes.”

Nor do appellees dispute the fact that, whereas the stockholder sought a decree adjudging *unlawful* the corporation’s conduct in the series of transactions in evidence, the corporation, on the other hand, sought to have the Court decree these transactions to have been *lawful* and

moreover, sought to have the Court declare that though these transactions were in fact *unlawful*, the corporation's right to relief was barred by the Statute of Limitations. And finally, nowhere in their briefs do appellees deny the realities which are exhibited by the facts, as set forth in appellant's Statement of the Case and Narrative of the Evidence. (Appellant's Op. Br. pp. 3-18.)

In sum, substance and effect, appellees admit that the Warner corporation is an adversary party in every sense of the word.

Appellees contend that nevertheless, the Warner corporation is to be aligned, not as the adversary party which it is, but as plaintiff's *ally*. They assert that such is in keeping with a "general rule" that the corporation "must be considered" as a plaintiff; that "this rule is almost a matter of definition in a derivative suit." Appellees cite *Groel v. Electric Co.*, 132 Fed. 252, as authority. (Op. Br. p. 6.)

Appellant replies that such is not and never has been the rule, general or otherwise; that neither the *Groel* case nor the cases decided in the Supreme Court, in this Court, or in any Circuit Court of Appeals, hold or suggest the existence of such a rule. To the contrary, in the *Groel* case, the rule deduced by Judge Lanning, after a "review of the authorities" (132 Fed. 263, 264) is, as quoted in appellant's brief (p. 21):

" . . . the stockholders' corporation will be aligned with the defendants whenever the officers or persons controlling the corporation are shown to be opposed to the objects sought by the complaining stockholder, and that, when such opposition does not appear, the stockholders' corporation will be aligned with the complainant in the suit."

Appellant submits that the test provided by the rule recommends itself for its objectivity and its freedom from complexity; it is logical and realistic; its application is not productive of an incongruous situation in which a party to a litigation is perceived as a complainant when in reality the party is a defendant, in every conceivable objective aspect of the term; in the case at bar, perceiving a party as a complainant when it is not only "rooting," so to speak, for complainant's defeat, but definitely striving to bring it about; and asserting to this Court moreover, that its directorate, undominated and uncontrolled, is, to a man, antagonistic to the objects of the suit.

The rule and its rationale underlie and form the basis of an impressive, unbroken line of decisions in the Supreme Court, in this Court, and in other Circuit Courts of Appeals.

In *Central Railroad v. Mills* (1884), 113 U. S. 249, a New Jersey citizen instituted a suit in his state court. The defendants named were his corporation, a New Jersey citizen, and a Pennsylvania corporation. Complainant stockholder challenged the legality of his company's conduct in leasing its railroad property to the co-defendant, the Pennsylvania corporation, and charged that thereby his company had been defrauded. The case was removed to the Federal Court. The defendants filed a joint answer. The Federal Court remanded the case to the State Court. It held that since stockholder and his corporation were both citizens of New Jersey, the Court had no jurisdiction. The Supreme Court affirmed the lower court's order to remand, saying (p. 256):

"All the defendants unite in defending the acts complained of, and in denying the illegality and fraud charged against them. The New Jersey corporation

is in no sense a merely formal party to the suit, or a party in the same interest with the plaintiffs; but is rightly and necessarily made a defendant. * * * All the parties on one side of this controversy not being citizens of different states from all those upon the other side, the citizenship of the parties did not bring the case within the jurisdiction of the Circuit Court."

In *Railroad v. Grayson* (1886), 119 U. S. 240, the complaining stockholder, Grayson, an Alabama citizen, instituted a suit in his state court. The defendants named were his company, Memphis and Charleston Co., a corporation existing under the laws of Alabama, Tennessee and Mississippi, and East Tennessee, Virginia and Georgia Railroad Co., a corporation existing under the laws of Tennessee and Georgia.

Complainant stockholder challenged the legality of his corporation's conduct in arranging to pay the co-defendant \$400,000 for a cancellation of a lease theretofore made by the stockholder's company to the co-defendant lessee, and authorizing an issue of \$5,000,000 of additional stock to be sold at 8 cents on the dollar for the purpose of raising the \$400,000. The case was removed to a Federal Court, which remanded it to the State Court on the ground that it had no jurisdiction since Grayson, complainant, and his corporation, Memphis and Charleston Co., defendant, were both citizens of Alabama. The Supreme Court affirmed. Chief Justice Waite writing for a unanimous court said:

"We are unable to distinguish this case from that of *N. J. Central Railroad v. Mills*, 113 U. S. 249 . . . Under these circumstances, it is clear that the Memphis and Charleston Company is not a mere

formal party, or a party in the same interest with Grayson, but is rightly and necessarily a defendant. The corporation, as a corporation, has determined, by a vote of its stockholders, to pay \$400,000, which it proposes to raise by a ruinous sale of stock, to get rid of a lease that Grayson insists is void and ought to be annulled without any payment whatever, and the lessee brought to an account. . . . Grayson is not suing for the Memphis and Charleston Company, but for himself. It is true a decree in his favor may be for the advantage of the Memphis and Charleston Company, but he does not represent the company in its corporate capacity, and has no authority to do so. As a stockholder, he seeks protection from the illegal acts of his own company as well as the other."

The Court's attention is respectfully directed to the fact that in neither the *Mills* case, nor the *Grayson* case, *supra*, was the stockholders' corporation shown to have been dominated by the co-defendants.

In *Venner v. Gt. Northern Ry.* (1907), 209 U. S. 24, 31-32, the Supreme Court reiterated its position in the *Mills* and *Grayson* cases, *supra*, cited those cases *and cited the Groel* case *supra*. It rejected contentions that the stockholder's corporation must be aligned alongside the complainant because the suit is the corporation's although instituted by the stockholder; that the stockholder and not the corporation is the real party in interest, and said again:

"It would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail. *But that is not enough.*

Both defendants unite, as sufficiently appears by the petition and other proceedings, *in resisting* the plaintiff's claim of illegality and fraud. They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant."

One year after the decision in the *Venner* case, *supra*, in *Delaware-Hudson Co. v. Albany and Susquehanna Railroad* (1909), 213 U. S. 435, the Court pointed out and stated clearly that the corporation's adversary position in the controversy need not be demonstrated to have proceeded from or to have been generated by sinister motives of those who administer the corporation's affairs. Speaking for a unanimous court, Justice McKenna said (p. 451):

"The attitude of the directors need not be sinister. It may be sincere. * * * In this case, it was certainly determined. It continued until after the suit was brought."

This was similarly the holding of the Seventh Circuit Court of Appeals in *Schmidt v. Esquire* (1954), 210 F. 2d 908. The Court said (p. 912):

"It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives."

The Court cited the *Delaware and Susquehanna* case, *supra*, *Ashwander v. Tennessee Valley Authority*, 297 U.

S. 288; (see Appellant's Op. Br. pp. 29-30); and *Groel v. The Electric Company*, *supra*.

Appellant submits that on both principle and authority the Warner corporation has been properly aligned as a defendant. (See 68 Harv. L. Rev., pp. 193-195; 38 Minn. L. Rev., pp. 877-880.)

In conclusion, appellant respectfully directs the Court's attention to a statement in appellees' brief (bot. p. 8, and top p. 9) to the effect that the Court below found as a fact, "that there was no fraud." Appellant submits that this statement is not borne out by the record.

The Court neither passed upon the merits of the controversy, nor did it make such a finding. The substance of the Court's findings, as pointed out in Appellant's Opening Brief (p. 6) is: The Warner directors "intended" the first contract (in the series of Warner-United contracts) to benefit the company; "considered" it to be a sound business arrangement and in approving and authorizing entry into this first contract, the directors acted in good faith and without fraud.

It is crystal clear that the Court did not find either the first Warner-United contract, or any of the superseding contracts, to be lawful, fair, and free from fraud. The Court made no determination thereon. It even declined to find that the first contract *was*, in fact, a sound business transaction or that it was, in fact, of benefit to the company. It inked out and deleted from appellees' *proposed* findings, a finding to this effect as well as to the effect that the *superseding contracts* (appellees termed them "amendments and supplements"), were, in fact, sound business transactions and of benefit to the company. [R. pp. 74-75.]

We submit that the learned District Court erred in concluding that it lacked jurisdiction of the First Cause of Action.

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We submit that the dismissal of the Second Cause of Action exhibits a patent inequity: The question of the Court's jurisdiction of the First Cause of Action was raised for the *first* time at the *pre-trial* hearing. (Opin. of the Court, 117 Fed. Supp. 781 at p. 788.) This occurred in March of 1953. The action had been pending for over *four years*. It was commenced on December 15, 1948. The opinion below was filed December 16, 1953.

As narrated in Appellant's Opening Brief (p. 17) and not contradicted by appellees, Warner parted with \$688,000.00—profits from two successful pictures brought out by the joint venture. This money went to United—in reality to Sperling. A substantial part thereof, viz., \$625,484.26, was paid during the years 1947, 1948 and 1949. [See Extracts from Exs. 105 and 105-A, Appens. A and B to this Br. pp. 1 to 4.]

Appellees' statement (Op. Br. bot. p. 32, and top p. 33) exhibits beyond any doubt that in a California state Court to which appellant is, in effect, relegated for the protection of his rights, he will be confronted with a plea by all the defendants, that inasmuch as this money was actually paid out by Warner in 1947, 1948, and 1949, recovery thereof is barred by the Statute of Limitations. Appellees say:

“We believe it plain, however, that the Statute of California would govern as the law of the forum; that

the relevant section is the three-year limitation under Section 388 of the State Code of Civil Procedure since the matter is essentially one of alleged fraud; that such period of three years under this statute runs from discovery by the aggrieved party; that here the corporation is clearly the aggrieved party under the authorities herein specified."

The judgment below, which dismisses the second cause of action notwithstanding defendants' silence on the jurisdictional issue *for over four years*, tolerates a situation in which this money may be lost, irretrievably; *i. e.*, though the California State Court—to which appellant is relegated to commence a *new* action for the protection of his rights—after hearing the merits of the controversy declare these Warner-United transactions to have been unlawful; find that Harry and Jack Warner were faithless to their trust; and conclude that but for the bar of the three-year statute of limitations, they would be adjudged liable for this sum.

For the reasons urged in Appellant's Opening Brief and in this reply brief, it is submitted, that the judgment should be reversed.

Respectfully submitted,

MOSS, LYON & DUNN and
HERMAN H. LEVY,

By HERMAN H. LEVY,

Attorneys for Appellant.

APPENDIX A.

Extract From Exhibit 105.

In the District Court of the United States, Southern District of California, Central Division.

Edward S. Birn, Plaintiff, v. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc. and Warner Bros. Pictures, Inc., Defendants. Civil Action No. 9005-WM.

INTERROGATORIES

To the Defendant United States Pictures Inc.:

Pursuant to the order of the court dated April 11, 1949, authorizing plaintiff to serve and file additional interrogatories, please furnish, under oath, written answers to the following interrogatories:

1. What are the itemized costs to United States Pictures Inc. in the production of the motion picture "Cloak and Dagger" and what sums have been received each month by United States Pictures Inc., to date, from the distribution of said motion picture.

2. What are the itemized costs to United States Pictures Inc. for the production of the motion picture "Pursued" and what sums have been received each month by United States Pictures Inc., to date, from the distribution of said motion picture.

APPENDIX B.

Extract From Exhibit 105A.

In the District Court of the United States, Southern District of California, Central Division.

Edward S. Birn, Plaintiff, v. Milton Sperling, Harry M. Warner, Jack L. Warner, United States Pictures, Inc. and Warner Bros. Pictures, Inc., Defendants. Civil Action No. 9005-WM.

ANSWER TO INTERROGATORIES SUBMITTED APRIL 21, 1949.

To the Plaintiff Edward S. Birn:

Defendant United States Pictures, Inc. (for convenience hereinafter referred to as "U. S.") answers herewith the interrogatories presented by plaintiff under date of April 21, 1949, as follows:

Answer To Interrogatory No. 1.

The itemized costs to U. S. in the production of the motion picture, "Cloak and Dagger," are set forth on Exhibit A attached hereto.

The following are the sums actually received by U. S. to date from the distribution of said picture (the dates set forth below are the dates on which the sums were deposited by U. S. or were paid to U. S. by invoice on Warner Bros. Pictures, Inc. and concurrent credit given by Warner Bros. Pictures, Inc. against moneys owed by U. S. to Warner Bros. Pictures, Inc.):

Date	
<u>Deposited or Invoiced</u>	<u>Amount</u>
4-26-47	4,807.38
5-31-47	8,183.74
6-20-47	11,593.19
7-28-47	71,614.08
8-2-47	9,813.46
8-22-47	52,490.58
8-23-47	7,487.09
9-4-47	34,748.41
9-4-47	5,496.94
11-7-47	21,241.79
11-13-47	3,467.84
1-25-48	59,051.35
2-6-48	7,979.30
4-22-48	51,160.41
5-7-48	6,759.34
8-17-48	12,173.46
10-13-48	4,553.60
10-13-48	39,351.44
1-10-49	44,254.81
4-14-49	17,162.50
	<hr/>
	<u>473,390.71</u>

Answer To Interrogatory No. 2.

The itemized costs to U. S. in the production of the motion picture, "Pursued," are set forth in Exhibit B attached hereto.

The following are the sums actually received by U. S. to date from the distribution of said picture (the dates set forth below are the dates on which the sums were deposited by U. S.):

<u>Date Deposited</u>	<u>Amount</u>
11-13-48	96,103.53
1-10-49	36,826.72
4-14-49	19,163.30

No. 14349.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE R. CARR,

Appellant,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Appellees.

On Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF OF APPELLANT

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Of Counsel.

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No. 14349.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE R. CARR,

Appellant,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Appellees.

BRIEF OF APPELLANT.

I.

PRELIMINARY STATEMENT.

This is an appeal by the plaintiff from a judgment of the United States District Court for the Southern District of California, Central Division, dismissing the complaint in a stockholders derivative action “* * * for lack of jurisdiction of this court over the subject matter * * *” [R. 272].

The plaintiff-appellant is a shareholder of the defendant-appellee, Beverly Hills Corporation [R. 3, 265], of which the individual defendants-appellees are, or have been, officers and directors [R. 4-5, 266], and the action is based upon a claim that the individual appellees abused their fiduciary position in various transactions which are set out in six counts of the complaint [R. 2-26], all of which must be taken as alleged upon a motion to dismiss.

II.

JURISDICTIONAL STATEMENT.

THE STATUTORY PROVISIONS.

The original jurisdiction of the United States District Court was invoked upon the ground that "The amount in controversy exceeds, exclusive of interest and costs, the sum of three thousand dollars (\$3,000.00)" [R. 3] and is between citizens of different states [R. 2-3]. The District Court had jurisdiction under Title 28, U. S. Code, Section 1332, which provides in part:

"Diversity of Citizenship; amount in controversy.

(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$3,000 exclusive of interest and costs, and is between:

(1) Citizens of different States;"

This court has jurisdiction of this appeal under Title 28, U. S. Code, Section 1291, which provides in part:

"Final decisions of district courts.

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, * * * except where a direct review may be had in the Supreme Court."

And under Title 28, U. S. Code, Section 1294, which provides in part:

"Circuits in which decisions reviewable.

Appeals from reviewable decisions of the district * * * courts shall be taken to the courts of appeals as follows:

(1) From a district court of the United States to the court of appeals for the circuit embracing the district;"

THE FACTS AS PERTAINING TO JURISDICTION.

The matter in controversy exceeds the sum or value of \$3,000 exclusive of interest and costs [R. 3, 25, 267].

At all times mentioned herein appellant, George R. Carr, has been, and he now is, a citizen of Illinois and a resident of Chicago, Illinois [R. 2, 261, 265]; appellee Beverly Hills Corporation (hereinafter for brevity sometimes called "the corporation" or "appellee corporation") has been and now is a corporation organized under the laws of California and a citizen of California [R. 2, 265]; and appellees John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, Harry F. Dietrich, and Ross J. Ferrar (hereinafter for brevity called "individual appellees") have been, and they now are, citizens of California [R. 3, 265].

III.

STATEMENT OF THE CASE.

Appellee Beverly Hills Corporation was organized in early 1949 for the purpose of acquiring a parcel of real estate in Beverly Hills, California, and constructing on a part of that real estate a modern, fully-equipped, building, designed to house an integrated medical clinic, and of leasing a portion of that building to a partnership of doctors for use as a medical clinic [R. 5-6, 223]; the corporation also planned to construct, equip, and operate for profit, within said building, an X-ray laboratory, a clinical laboratory, and a pharmacy and soda fountain, to construct a paved parking lot on the unoccupied portion of its real estate, adjoining the building, and to operate that parking lot for profit [R. 6-7, 33, 145, 148, 173-174, 179-181, 203, 223-224, 228, 230]. The income of the

corporation would thus be made up of the rent to be received from the lease of the clinic portion of the building and the profits to be realized from the operation of the other named facilities [R. 148-150, 155, 173, 180-181, 223-224].

Pursuant to said plan the corporation was organized and, on February 28, 1949, appellees Lordan, Brandsma, Browne, Langley, and Dietrich were elected directors of the corporation, they constituted the entire board of directors [R. 4, 90, 94, 101, 110, 114]; appellee Lordan was elected president of the corporation on the same date, and still holds that office [R. 4, 114]; appellee Brandsma was elected secretary-treasurer of the corporation on the same date and held that office until November 17, 1950, when he was elected vice-president [R. 4, 90]. Appellee Ferrar became general business manager of the corporation on September 15, 1950, and still holds that office [R. 4, 105], he became treasurer of the corporation on November 17, 1950, and became secretary of the corporation on or about November 12, 1952, and still holds those offices [R. 4-5, 105].

At all times since October 10, 1950, all of the individual appellees have been, and they now are, members of the Executive Committee of the corporation; they comprise the entire Executive Committee [R. 5].

During the holiday season of 1949-1950, and in April, 1950 [R. 145, 203, 225-226], appellant learned of the proposed corporation and its plans and purposes from appellees Lordan and Brandsma and from his son-in-law, Dr. Omar Fareed [R. 145, 203-204, 225-226, 260-261] and, wishing to help provide for the Los Angeles area an outstanding medical clinic in which his son-in-law could participate [R. 260-261] he, in about April, 1950, pur-

chased 400 shares of the common stock of the corporation and loaned \$20,000 in cash to the corporation [R. 3, 146, 204, 261]. This was the first cash the corporation had received and it gave the corporation some standing with the bank [R. 261].

Thereafter, during 1950 and 1951, the corporation acquired by purchase ten (10) lots, constituting a single parcel of ground in Beverly Hills, California, for a consideration of about \$300,000, and constructed thereon a medical clinic building which occupied about three (3) lots [R. 6]; in 1951 it acquired by lease from Martha Lordan, wife of appellee John Lordan, an additional adjoining lot, hereinafter referred to as "lot 761" [R. 6, 27], and in 1952 purchased said lot 761 for \$35,000 [R. 6]. The corporation also graded, paved, and equipped, as a parking lot, the unoccupied portion of its real estate, consisting of about eight (8) lots and including lot 761 [R. 6].

During 1951 the corporation completed the construction and equipping of its building, including a clinical laboratory, an X-ray laboratory, and a pharmacy and soda fountain, and leased the greater portion of the building, other than the above facilities, for use as a medical clinic, to a partnership of doctors doing business under the style "The Beverly Hills Clinic" [R. 6-7, 155]. The building was completed and The Beverly Hills Clinic commenced its operations on or about September 1, 1951 [R. 155, 177-178, 199, 200, 227].

The Beverly Hills Clinic (hereinafter for brevity sometimes called "The Clinic"), lessee of most of the corporation's building, was a co-partnership of doctors and of one registered pharmacist, appellee Ferrar [R. 5, 105, 224];

all of the individual appellees were members and general partners of, and financially interested in, The Clinic [R. 5, 90, 94, 101, 105, 110, 114]; neither appellant nor appellee corporation was a member or general partner in, or financially interested in, The Clinic [R. 5].

The partners in The Beverly Hills Clinic, including appellee Ferrar, own and hold 91% of the outstanding stock of the corporation; the six individual appellees, alone, own and hold 42.1% of said stock [R. 60].

During 1951 and 1952 the individual appellees, as officers and directors of the corporation, caused the parking lot, the X-ray laboratory, and the clinical laboratory to be diverted, as profit-making facilities, from the corporation to The Clinic, and thereby to themselves as members and general partners of The Clinic [R. 9-10, 16-17, 19, 20, 148-150, 173-174].

In May, 1952, while the corporation, under the terms of its lease from appellee Lordan, held a first right of refusal to purchase lot 761 [R. 28], the individual appellees failed and refused to assert said right and permitted appellee John P. Lordan and his wife to sell said lot for \$18,500 [R. 10, 17-18, 164-167] and paid \$500 of the corporation's funds to the new owners of lot 761 for an option to purchase said lot for \$35,000 [R. 30-31], and several days later did in fact purchase said lot 761 for the corporation for \$35,000 on or about May 27, 1952, from the vendees of John and Martha Lordan [R. 10, 17-18, 66-67, 117-118].

In 1951 the individual appellees fraudulently and wrongfully caused and permitted the pharmacy within its building to be diverted, as a profit-making facility, from the corporation and to be placed under lease to appellee Ferrar

(with a remainder to appellee Lordan) [R. 39-41], who agreed to operate it as an accommodation to, and for the use and benefit of, the corporation [R. 21-24, 149, 169-172]. Since about September 1, 1951, appellee Ferrar has been in possession of said pharmacy and has denied his trust and asserts that the profits from said pharmacy are his own [R. 24, 107-108].

After the corporation had been stripped of all of its profit-making facilities, as described above, the end result was that not only had it lost its expected profits but all of its income was derived from rent [R. 10-11, 148-150], it became a personal holding company within the meaning of the Internal Revenue Code and subject to taxation as such [R. 11, 148-150], the corporate purposes were destroyed, and the majority stockholders voted to wind up and dissolve the corporation [R. 11, 128].

In November, 1952, appellant, in Chicago, Illinois, received a telephone call from appellee Lordan in Los Angeles, California, telling appellant of the state of the corporation's affairs [R. 145, 236, 261]. Appellee Lordan then sent appellant a letter dated November 13, 1952, confirming said telephone conversation [R. 146, 148-153, 236-237]. Said telephone conversation and letter were the first information appellant had received of the manner in which the corporation had been stripped of its income-producing facilities [R. 146, 261] and he immediately instituted an investigation into the manner in which the affairs of the corporation were being handled [R. 147].

In early December, 1952, appellant's attorneys commenced an investigation into the manner in which the corporation's affairs had been managed in respect of the foregoing transactions [R. 9, 12, 125]. At about that time appellant's attorneys were informed by appellee Lor-

dan that the Los Angeles law firm of Gibson, Dunn & Crutcher had been retained as legal counsel for the corporation [R. 12, 125, 135].

Thereafter, during December, 1952, and January, February, and March, 1953, appellant's attorneys made many requests and repeated efforts to inspect the books and records of appellee corporation [R. 154] and to investigate the above transactions, but they were permitted to make only a limited inspection [R. 9, 11-16]. In mid-March, 1953, the attorneys for appellee corporation learned that appellant had prepared and was about to file a derivative action against the appellees [R. 15, 133]; thereafter, on or about March 24, 1953, the attorneys for appellee corporation instigated proceedings [R. 134] to have appellees Brandsma, Browne, Langley, and Dietrich resign as directors of the corporation and to choose and elect their own successors. This was done [R. 15-16, 134, 136]. Appellee Lordan remained a director and president of the corporation [R. 114]; appellee Ferrar remained as secretary-treasurer and general business manager of the corporation [R. 105]. All of the individual appellees continued as members of the executive committee of the corporation [R. 5].

Having been unsuccessful in his efforts to obtain relief through the corporation [R. 9, 11-16] appellant, on April 30, 1953, filed his derivative action in the District Court [R. 2-45]. The law firm of Gibson, Dunn & Crutcher, from which appellant's attorneys had been trying to secure vital information of the corporation's affairs for nearly four months, continued to represent appellee corporation until on or about May 4, 1953 [R. 142]; at all times herein mentioned they have represented, and do now represent, the individual appellees. On or about

May 4, 1953, appellee corporation retained its present counsel, the law firm of Latham & Watkins [R. 142].

Appellee corporation and the individual appellees, on July 22, 1953, filed their separate motions (1) to dismiss for failure to state a claim upon which relief can be granted [R. 46, 88] or (2) in the alternative, for a security bond pursuant to Section 834(b) of the California Corporations Code [R. 46, 88]. The individual appellees also moved to strike the complaint as sham, false, vexatious, and frivolous [R. 88]. The question of jurisdiction over the subject matter, based upon diversity of citizenship, was never raised by the parties. Said motions having been argued and submitted for decision the District Court, on December 10, 1953, made its order dismissing said motions on the ground that it probably lacked jurisdiction over the subject matter of the action and hence lacked jurisdiction to entertain the motions [R. 253].

Thereafter, on December 23, 1953, appellee corporation and the individual appellees filed their separate motions (1) to dismiss the complaint for lack of jurisdiction over the subject matter of the action and (2) in the alternative, renewing their previous motions [R. 254, 257]. Said motions were argued and submitted to the court on January 11, 1954, and the court then announced its decision that the motions to dismiss for lack of jurisdiction over the subject matter were granted, and on January 27, 1954, made and filed its Findings of Fact and Conclusions of Law [R. 264] and Judgment [R. 271].

Appellant filed his Notice of Appeal on February 25, 1954 [R. 274].

IV.

SPECIFICATION OF ERRORS.

1. The District Court Erred in Holding That, for the Purpose of Determining Whether Diversity of Citizenship Exists in the Within Action, the Defendant Corporation Must Be Realigned With the Plaintiff as a Plaintiff.

This holding was erroneous because in testing diversity of citizenship the parties must be arranged on different sides of the matter in dispute *according to the facts*. In stockholder's derivative actions the stockholder's corporation is aligned with the defendant when the corporation is under control antagonistic to the stockholder and opposed to the object sought by him.

2. The District Court Erred in Holding That the Defendant Corporation Has Not Been Under the Domination of the Individual Defendants, or Any of Them, or Under the Control of Any Person or Persons Who Have Been Antagonistic or Hostile to the Financial Interests of the Corporation at Any Time Since at Least as Early as March 25, 1953.

This holding was erroneous since at all times pertinent to this case the corporation has been in the hands of the individual defendants, or of the persons selected by the individual defendants for the purpose of opposing the plaintiff's claims and, at the time of commencement of this action, was represented by counsel for the individual defendants. The individual defendants are also the dominant stockholders of the corporation.

3. The District Court Erred in Holding That the Corporation Was Not at the Time of the Commencement of the Within Action, and Is Not Now, Incapacitated From Bringing or Maintaining Suit Upon the Causes of Action Set Forth in Plaintiff's Complaint Herein and From Protecting Its Own Financial Interests.

A corporation can act only through its board of directors; therefore, when the board of directors refuses to enforce rights of the corporation, that corporation is, as a practical matter, incapacitated from acting in respect of such rights.

4. The District Court Erred in Holding That the Within Action Is Not One Between Citizens of Different States and That the Requisite Diversity of Citizenship Between the Plaintiff on the One Hand, and the Defendants on the Other, Did Not Exist at the Time of the Commencement of the Within Action and Does Not Now Exist and That It Did Not Then and Does Not Now Have Jurisdiction Over the Subject Matter.

This finding is erroneous since in this case the defendant corporation, when aligned *according to the facts*, must be aligned as a party defendant; when that is done there is complete diversity of citizenship between the plaintiff, a citizen of Illinois, and the defendants, consisting of a California corporation and individual defendants who are citizens of California. When the other jurisdictional requirements are present, as is true in this case, the District Court has jurisdiction over the subject matter.

5. The District Court Erred in Dismissing the Within Action for Lack of Jurisdiction Over the Subject Matter.

This conclusion and judgment is erroneous since the facts of the case as pleaded and established show that there was complete diversity of citizenship between the parties and all other jurisdictional facts appeared and, therefore, the court had jurisdiction over the subject matter.

V.

SUMMARY OF ARGUMENT.

The federal courts possess only such jurisdiction as is conferred upon them by the constitution and the laws of the United States. It is, therefore, incumbent upon the federal courts to examine their jurisdiction at the threshold of each case. In doing so the jurisdiction of the court must be determined with reference to the attitude of the case at the time of the filing of the action, and if jurisdiction exists at that time it cannot be ousted by subsequent events.

In examining federal jurisdiction which is invoked upon the basis of diversity of citizenship, the court is not bound by the arrangement in which the pleader has placed the parties, but will look beyond the pleadings and arrange the parties *according to the facts*.

In a stockholder's derivative action, such as instant case, the rule is that even though the cause of action asserted by the plaintiff will, if successful, inure to the benefit of the corporation, and the corporation is a real party in interest and an indispensable party, the corporation is, for purposes of testing diversity of citizenship,

aligned with the defendants whenever the officers or persons controlling the corporation are opposed to the object sought by the complaining stockholder and under a control antagonistic to him and detrimental to his rights. This has always been the rule in cases in which, as here, the management of the corporation has taken a position adversary to the plaintiff in the actual litigation of the case. The rule is not limited to those cases in which the individual defendants, the wrongdoers, constitute the management of the corporation, but it is also applied in those cases in which there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives.

In those cases which may be characterized as “collusive” suits, or where there is a want of equity in the plaintiff, the action will, of course, be dismissed. Such facts are not found in instant case.

At the time of the commencement of the within action the corporation was dominated and controlled by the individual defendants and other persons who were antagonistic to the plaintiff and the objects sought by him.

A corporation can act only through its board of directors; therefore, when the board of directors refuses to enforce rights of the corporation, that corporation is, as a practical matter, incapacitated from acting in respect to such rights.

In the instant case, when the corporation is aligned *according to the facts* of its position in the controversy it must be aligned as a defendant. So aligned, there is complete diversity of citizenship, the other jurisdictional requirements are present, the court had jurisdiction over the subject matter, and the court erred in dismissing the action for lack of jurisdiction over the subject matter.

VI.

ARGUMENT.

A. Introduction.

This appeal seeks to reverse the decision of the District Court dismissing the complaint in a stockholder's derivative action for lack of jurisdiction over the subject matter. The District Court based its decision and judgment upon findings that, although complete diversity appeared from the face of the complaint [R. 2-3, 268], for the purpose of testing whether diversity in fact existed the defendant corporation, as a real party in interest, must be realigned with the plaintiff [R. 268]; after being so realigned the requisite diversity of citizenship between the plaintiffs and defendants did not exist and the court lacked jurisdiction over the subject matter and for that reason dismissed the complaint [R. 269]. The real question in this appeal is, therefore, "Did the District Court err in dismissing the complaint for lack of diversity of citizenship, and therefore lack of jurisdiction?"

As a preliminary matter it is pointed out that the decision of the District Court was in no way based upon an alleged failure of the plaintiff to comply with the requirements of Rule 23(b), Federal Rules of Civil Procedure. The verified complaint alleged, and the court found, that the plaintiff was a shareholder in the corporation at the times of the transactions complained of [R. 3, 265], that the action was not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction [R. 3, 267], and that *it would have been futile for the plaintiff to make further demands upon the corporation for relief* [R. 266] *in view of his previous efforts as alleged with particularity in the complaint* [R. 9, 11-16].

B. The District Court Erred in Holding That for the Purpose of Determining Whether Diversity of Citizenship Exists the Defendant Corporation Must Be Realigned With the Plaintiff.

Since the federal courts possess only such jurisdiction as has been conferred upon them by the Congress, within the limits prescribed by the United States Constitution (Art. III, Sec. 2), and the lack of federal jurisdiction cannot be waived or overcome by the agreement of the parties, it is incumbent upon the courts to examine their jurisdiction at the threshold of each case. (*Smith v. Sperling* (S. D. Calif., 1953), 117 Fed. Supp. 781, 787.)

In the words of Mr. Chief Justice Marshall:

“It is most true that this court will not take jurisdiction if it should not; but it is equally true that it must take jurisdiction if it should. The judiciary cannot, as the legislature may, avoid a measure because it approaches the confines of the Constitution. We cannot pass it by because it is doubtful. With whatever doubts, with whatever difficulties, a case may be attended, we must decide it, if it be brought before us. We have no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given.”

Cohens v. Virginia (1821), 6 Wheat. 264, 404, 5 L. Ed. 257, 291.

The jurisdiction of the court must be determined with reference to the attitude of the case at the date of the filing of the bill; if jurisdiction exists at the time when the action is brought, it cannot be ousted by subsequent events. (*City of Chicago v. Mills* (1907), 204 U. S. 321, 328, 27 S. Ct. 286, 51 L. Ed. 504; *Grant County Deposit Bank v. McCampbell* (6th Cir., 1952), 194 F. 2d 469, 31 A. L. R. 2d 909, 916.) Thus where diversity juris-

diction exists at the commencement of an action a subsequent change of citizenship of one of the parties does not oust it, and likewise the citizenship of a subsequent intervening plaintiff is immaterial. (*City of Chicago v. Mills* (1907), 204 U. S. 321, 328 (*supra*); *Wichita R. R. & Light Co. v. Public Utilities Comm.* (1922), 260 U. S. 48, 53-54, 43 S. Ct. 51, 67 L. Ed. 124; *Jeffcott v. Donovan* (9th Cir., 1943), 135 F. 2d 213; *Smith v. Sperling* (S. D. Cal., 1953), 117 Fed. Supp. 781, 788; *Weinstock v. Kallett* (S. D. N. Y., 1951), 11 F. R. D. 270, 272.) Where federal jurisdiction is invoked on the basis of diversity of citizenship, however, the court will not be bound by the arrangement in which the pleader has placed the parties but it will "look beyond the pleadings and arrange the parties according to their sides in the dispute." (*Dawson v. Columbia etc. Trust Co.* (1905), 197 U. S. 178, 180, 49 L. Ed. 713.)

In a stockholder's derivative action the stockholder is asserting a cause of action belonging to his corporation and the courts have uniformly held that in such cases his corporation is not only a real party in interest but is also an indispensable party and the citizenship of the corporation must be considered in aligning the parties for the purpose of testing jurisdiction. (*Davenport v. Dows* (1873), 18 Wall. 626, 21 L. Ed. 938; *Groel v. United Electric Co.* (C. C. N. J., 1904), 132 Fed. 252, 254; *Dawson v. Columbia etc. Trust* (1905), 197 U. S. 178, 49 L. Ed. 713; *Venner v. Gt. Northern Ry.* (1908), 209 U. S. 24, 31-32; *Koster v. (American) Lumbermen's Mutual Cas. Co.* (1947), 330 U. S. 518, 67 S. Ct. 828, 91 L. Ed. 1067.) Since the cause of action asserted in a stockholder's derivative action is that of the corporation it would appear that the corporation should be aligned as

a party plaintiff for the purposes of testing jurisdiction. That is not the case, however, when the corporation has taken a position relative to the dispute which is hostile and antagonistic to that of the plaintiff-stockholder, it is then aligned as a defendant.

(1) The Alignment of Parties in Stockholder's Derivative Actions.

(a) GENERALLY.

For the purposes of determining jurisdiction based upon diversity of citizenship the courts have long been guided by the rule of Mr. Chief Justice Waite in the *Removal Cases* (1879), 100 U. S. 457, 469, 25 L. Ed. 593, 598:

“For the purposes of a removal the matter in dispute may be ascertained, and the parties to the suit arranged on opposite sides of that dispute. If in such arrangement it appears that those on one side are all citizens of different states from those on the other, the suit may be removed. Under the old law the pleadings only were looked at, and the rights of the parties in respect to a removal were determined solely according to the positions they occupied as plaintiffs or defendants in the suit. * * * Under the new law the mere form of the pleadings may be put aside, and the parties placed on different sides of the matter in dispute *according to the facts.*” (Emphasis added.)

Twenty-five years later the rule of the *Removal Cases* was discussed, and the decisions of the intervening years were reviewed in the oft-cited opinion in *Groel v. United Electric Co.* (C. C. N. J., 1904), 132 Fed. 252. In that case the plaintiff, a citizen of New Jersey, brought a stockholder's action against a New Jersey corporation in which

he was a stockholder, and against a Pennsylvania corporation, in the Court of Chancery of New Jersey. The Pennsylvania corporation had the case removed to the federal court on the theory that since the plaintiff was urging the New Jersey's corporation's cause of action that company could not be aligned as a defendant but must either be deemed a nominal party or be aligned with the plaintiff. The cause was heard on a motion to remand, and the court, after reviewing many decisions following the *Removal Cases*, said (p. 263):

“This contention has seemed to necessitate the foregoing review of the authorities. The rule deduced from them is that, in a suit in equity instituted by a stockholder in his own name, but upon a right of action existing in his corporation, the stockholder's corporation will be aligned with the defendants whenever the officers or persons controlling the corporation are shown to be opposed to the object sought by the complaining stockholder, and that, when such opposition does not appear, the stockholder's corporation will be aligned with the complainant in the suit.” (132 Fed. at 263-264.)

In the *Groel* case the court held that the stockholder's corporation must remain where the pleader placed it, as a defendant, which in that case destroyed citizenship and ousted federal jurisdiction.

The decision in the *Groel* case has been cited with approval by the Supreme Court in *Venner v. Gt. Northern Ry. Co.* (1908), 209 U. S. 24, 28 S. Ct. 328, 52 L. Ed. 666; and *Hamer v. New York Railways* (1917), 244 U. S. 266, 37 S. Ct. 511, 61 L. Ed. 1125; and in various decisions of the Courts of Appeals, including *Lavin v.*

Lavin (2nd Cir., 1950), 182 F. 2d 870, 18 A. L. R. 2d 1017, wherein Chief Judge Hand said:

"We need not deal at length with the plaintiff's suggestion that it is only when the jurisdiction of the federal courts will be sustained that in such actions the corporation may not be aligned as a plaintiff. True, so far as we have found that has been the case in all decisions of the Supreme Court, but it was not true in *Groel v. United Electric Company*, C. C. N. J., 132 F. 252, or in *Kelly v. Mississippi River Coaling Company*, C. C., 175 F. 482, which the Supreme Court cited with apparent approval in *Hamer v. New York Railways*, 244 U. S. 266, 37 S. Ct. 511, 61 L. ed. 1125. It may indeed be doubted whether as an original question the Supreme Court would not today align the corporation as a party plaintiff in all cases; nevertheless it has shown no disposition to change the rule in *Doctor v. Harrington*, 196 U. S. 579, 25 S. Ct. 355, 49 L. ed. 606, but has recognized its continued authority."

See also:

Schmidt v. Esquire, Inc. (7th Cir., 1954), 210 F. 2d 908.

The Supreme Court followed the same rule in the leading case of *Doctor v. Harrington* (1905), 196 U. S. 579, 25 S. Ct. 355, 49 L. Ed. 606. In that case the plaintiff-stockholders were citizens of New Jersey and brought a derivative action against the corporation defendant, in which they were stockholders, a New York citizen, and against individual defendants who were citizens of New York. In holding that the federal courts had cognizance of such an action the court said:

"The ninety-fourth rule in equity contemplates that there may be, and provides for, a suit brought

by a stockholder in a corporation, founded on rights which may properly be asserted by the corporation. And the decisions of this court establish that such a suit, when between citizens of different states, involves a controversy cognizable in a circuit court of the United States. The ultimate interest of the corporation made defendant may be the same as that of the stockholder made plaintiff; but the corporation may be under a control antagonistic *to him*, and made to act in a way detrimental to *his* rights. In other words, *his* interests, and the interests of the corporation may be made subservient to some illegal purpose. If a controversy hence arise, and the other conditions of jurisdiction exist, it can be litigated in a Federal Court.” (Emphasis added.)

In the case of *Venner v. Gt. Northern Ry.* (1908), 209 U. S. 24, 31-32, 28 S. Ct. 328, 52 L. Ed. 666, the Supreme Court held that there was diversity of citizenship to support federal jurisdiction in a case in which a citizen of New York, as plaintiff, brought an action against the corporation in which he was a stockholder and an individual defendant, both of whom were citizens of Minnesota. The action was instituted in a New York state court and was removed to the federal court on petition of the defendants. In considering the question of jurisdiction the court said:

“First, was there a controversy between citizens of different states? * * * Let it be assumed for the purposes of this decision that the court may disregard the arrangement of parties made by the pleader, and align them upon the side where their interest in and *attitude to the controversy* really place them, and then may determine the jurisdictional question in view of this alignment. Removal Cases, 100 U. S. 457, * * * If this rule should be ap-

plied it would leave the parties here where the pleader has arranged them. It would doubtless be for the financial interests of the defendant railroad that the plaintiff should prevail. But that is not enough. Both defendants unite, as sufficiently appears by the petition and other proceedings, in resisting the plaintiff's claim of illegality and fraud. They are alleged to have engaged in the same illegal and fraudulent conduct, and the injury is alleged to have been accomplished by their joint action. The plaintiff's controversy is with both, and both are rightfully and necessarily made defendants, and neither can, for jurisdictional purposes, be regarded otherwise than as a defendant. (Citations.) The case of *Doctor v. Harrington* is precisely in point on this branch of the case and is conclusive. * * *

(Emphasis added.)

The same rule was followed by the Supreme Court as recently as 1947 in the case of *Koster v. (American) Lumbermen's Mutual Cas. Co.* (1947), 330 U. S. 518, 67 S. Ct. 828, 91 L. Ed. 1067, and in 1954 by the Seventh Circuit in *Schmidt v. Esquire, Inc.* (7th Cir., 1954), 210 F. 2d 908. In the *Schmidt* case an Illinois stockholder-plaintiff brought an action in an Indiana state court against his own Delaware corporation and other Delaware corporations. The case was removed to the federal court on petition of the defendants other than the plaintiff's corporation. Plaintiff's motion to remand urged that plaintiff's corporation should be aligned as a party plaintiff for the purposes of testing diversity of citizenship and that there would then be a Delaware corporation on each side of the controversy and no federal jurisdiction. The court denied the motion to remand, saying:

"The plaintiff's motion to remand was based principally on the theory that, although Tucker Corpora-

tion was named as a defendant in the complaint, for the purposes of testing diversity jurisdiction it should have been re-aligned as a plaintiff in accordance with its actual interest in the controversy. Thus, diversity would have been destroyed by the presence of a Delaware corporation on each side of the case. We note that in stockholder's derivative actions it has not been the practice to realign the corporation as a plaintiff, although the action is one to enforce a corporate claim and any recovery is for the benefit of the corporation. *Koster v. (American) Lumbermens Mutual Cas. Co.*, 330 U. S. 518, 67 S. Ct. 828, 91 L. ed. 1067; *Meyer v. Fleming*, 327 U. S. 161, 66 S. Ct. 382, 90 L. ed. 595; *Venner v. Gt. Northern Ry. Co.*, 209 U. S. 24, 28 S. Ct. 328, 52 L. ed. 666; *Doctor v. Harrington*, 196 U. S. 579, 25 S. Ct. 355, 49 L. ed. 606; *Lavin v. Lavin*, 2 Cir., 182 F. 2d 870, 18 A. L. R. 2d 1017. The corporation is left a defendant on the theory that it is controlled by antagonistic hands. * * * It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives. See *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, 56 S. Ct. 466, 80 L. ed. 688; * * *” (210 F. 2d 908, at 911.)

Thus the general rule as to the alignment of parties in stockholder's derivative actions seems to be, as stated in *Groel v. United Electric Co. (supra)* (C. C. N. J., 1904), 132 Fed. 252, 263:

“The rule * * * is that, in a suit in equity instituted by a stockholder in his own name, but upon a right of action existing in his corporation, the stockholder's corporation will be aligned with the

defendants whenever the officers or persons controlling the corporation are shown to be opposed to the object sought by the complaining stockholder, * * *."

See also, in this connection, supporting this well-established rule:

Meyer v. Fleming (1946), 327 U. S. 161, 66 S. Ct. 382, 90 L. Ed. 595;

Cutting v. Woodward (9th Cir., 1918), 255 Fed. 633;

Annotation, 132 A. L. R. 193, at 197-202, and cases collected there;

Moore's Federal Practice (2nd Ed.), Secs. 23.21 and 19.03;

2 *Barron & Holtzoff*, Sec. 569, p. 177;

Opici v. Cucamonga Winery, et al. (S. D. Cal., 1947), 73 Fed. Supp. 603;

Dodge v. Woolsey, 18 How. 331, 15 L. Ed. 401;

New Jersey Central R. Co. v. Mills, etc. (1885), 113 U. S. 249, 5 S. Ct. 456, 28 L. Ed. 949;

Greenwood v. Freight (1882), 105 U. S. 13, 26 L. Ed. 961;

East Tennessee etc. R. Co. v. Grayson (1886), 119 U. S. 240, 7 S. Ct. 190, 30 L. Ed. 382.

(b) ALIGNMENT OF PARTIES WHERE THE CORPORATION'S MANAGEMENT OPPOSES THE STOCKHOLDER'S DERIVATIVE ACTION.

In those cases, as in the case at bar, in which the management of the corporation has appeared and answered, or otherwise taken an adversary position in the actual litigation of a stockholder's derivative action, the corporation has been aligned as a party defendant for the purposes of jurisdiction.

An early case illustrating this principle is *New Jersey Central R. Co. v. Mills, etc.* (1885), 113 U. S. 249, 5 S. Ct. 456, 28 L. Ed. 949. In that case the plaintiff, a New Jersey citizen, brought an action in a New Jersey court against a New Jersey corporation in which he was a stockholder, and a Pennsylvania company. The case was removed to the federal court and all of the defendants filed a joint answer. The motion to remand, on the grounds that there was no diversity of citizenship since the plaintiff's corporation had to be aligned as a defendant, was granted. The Supreme Court affirmed the lower court saying:

"All the defendants unite in defending the acts complained of, and in denying the illegality and fraud charged against them. *The New Jersey corporation is in no sense a merely formal party to the suit, or a party in the same interest with the plaintiffs, but is rightly and necessarily made a defendant.*
* * *"

(Emphasis added.)

The next year Mr. Chief Justice Waite decided a similar situation in *East Tennessee etc. R. Co. v. Grayson* (1886), 119 U. S. 240, 7 S. Ct. 190, 30 L. Ed. 382. This, again, was a case started in a state court, removed to the federal court, and then remanded; the issue was whether or not there was diversity of citizenship. In a situation closely parallel to the *New Jersey Central* case Mr. Chief Justice Waite said:

"We are unable to distinguish this case from *New Jersey Central R. v. Mills*, 113 U. S. 249 * * *"

The stockholder's corporation, made defendant,

"* * * is not a mere formal party, or a party in the same interest with Grayson, but is rightly and necessarily a defendant. The corporation, as a cor-

poration, has determined, by a vote of its stockholders, to pay \$400,000, which it proposes to raise by a ruinous sale of stock, to get rid of a lease that Grayson insists is void and ought to be annulled without any payment whatsoever, * * * (H)ere the allegations of the bill, which, for the purposes of the present inquiry, must be considered as confessed, are to the effect that the two companies are acting in harmony upon the question of validity. * * * This is certainly the equivalent of the joint answer in the other case." (Referring to *New Jersey Central R. v. Mills.*)

In *Delaware & Hudson Co. v. Albany & Susquehanna R. Co.* (1909), 213 U. S. 435, 451, 29 S. Ct. 540, 53 L. Ed. 862, Mr. Justice McKenna reached a similar holding in a case in which the corporate defendant had demurred to the stockholder's bill.

This court has, in *Cutting v. Woodward* (9th Cir., 1918), 255 Fed. 633, 635, held in accordance with the above-quoted authorities. The facts there are reflected in the pertinent portion of the opinion, as follows:

"The trust company raises the question of jurisdiction, asserting that the company is not an adversary party to the plaintiffs in the suit, but is the real party in interest as plaintiff, and that consequently there is no diversity of citizenship. But this is not a case in which the trust company, although made a defendant, should be realigned as a plaintiff, as in *Hamer v. New York Railways*, 244 U. S. 266, 274, 61 L. ed. 1125. *Here the attitude of the trust company is hostile to the plaintiffs. It appeared in a joint answer with the appellant, and by the same counsel, and it denied the allegations of the bill and prayed for the dismissal thereof.* The cause is therefore one in which plaintiffs, citizens of Illinois, bring

suit against defendants who are citizens of California. *Doctor v. Harrington*, 196 U. S. 579, 49 L. ed. 606; *Venner v. Gt. Northern Railway*, 209 U. S. 24, 52 L. ed. 666.” (Emphasis added.)

The *Cutting v. Woodward* decision is particularly interesting and pertinent to instant appeal. There, as here, there was an Illinois citizen as party plaintiff; there, as here, the defendants were a California corporation and individual citizens of California; there, as here, it was urged that the plaintiff’s corporation should be realigned as a plaintiff, which would defeat federal jurisdiction. There, as here, the attitude of the defendant corporation was hostile and actually opposed to the plaintiff, and it appeared, and denied the allegations of the bill, and prayed for the dismissal of the action. The differences between the two cases are, indeed, very slight. There the defendant corporation appeared by the same counsel as the individual defendants; in the case at bar the defendant corporation by a recent change *no longer* appears by the same counsel as the individual defendants *but it did at one time do so*, from the beginning of negotiations between plaintiff-appellant, in early December, 1952 [R. 12, 125, 135], until *after* this action was filed, namely, until May 4, 1953 [R. 142], five days after this action was filed. And clearly the present attorneys for all of the appellees recognize no adversary position between each other, for the attorneys who represented the defendant-appellee corporation until May 4, 1953, are still representing the individual defendants-appellees. As to pleadings, it is true that the individual and corporate appellees have not filed joint pleadings, but it is also true that they have filed motions on the same dates, asking for the same relief [R. 46 and 88, 254 and 257], and generally

“* * * are acting in harmony * * *” which is “* * * certainly the equivalent of the joint answer in the other case.” (*East Tennessee R. Co. v. Grayson* (*supra*), 119 U. S. 240.)

This is also the rule of the California Supreme Court, *Wickersham v. Crittenden* (1895), 106 Cal. 329, 331, 39 Pac. 603.

See also:

Nagle v. Wyoga Gas & Oil Corp. (1935), 10 Fed. Supp. 905.

(c) ALIGNMENT OF PARTIES IN A STOCKHOLDER'S DERIVATIVE ACTION WHERE THE CORPORATION'S MANAGEMENT IS NOT DOMINATED BY THE WRONGDOERS.

In making its findings of fact and conclusions of law the District Court found, *inter alia*, that the defendant corporation has not been under the domination of the individual defendants, or any of them, or under the control of any person or persons who have been antagonistic or hostile to the corporation at any time since at least as early as March 25, 1953.

A study of the decisions relative to the alignment of parties in that type of fact situation reveals that the courts again apply the rule of *Doctor v. Harrington*, 196 U. S. 579 (*supra*), and of *Groel v. United Electric Co.* (1904), 132 Fed. 252. As the Court of Appeals for the Seventh Circuit recently held, *Schmidt v. Esquire, Inc.* (1954), 210 F. 2d 908, 911:

“It does not seem that a different rule of alignment applies when, as in this case, there is no indication that the refusal by the corporate management to sue results from fraudulent or other improper motives. See *Ashwander v. Tennessee Valley Au-*

thority, 297 U. S. 288, 56 S. Ct. 466, 80 L. ed. 688; Hill v. Wallace, 259 U. S. 44, 42 S. Ct. 453, 66 L. ed. 822; Delaware & Hud. Co. v. Albany & Susquehanna R. Co., 213 U. S. 435, 29 S. Ct. 540, 53 L. ed. 862; City of Chicago v. Mills, 204 U. S. 321, 27 S. Ct. 286, 51 L. ed. 504; Groel v. United Electric Co., C. C., 132 F. 252.”

In the *Groel* case, *supra*, cited in *Schmidt v. Esquire, Inc.*, the management of the plaintiff's corporation did not receive the unlawful profits, it merely refused to bring the requested action to recover said profits (132 Fed. 252, 265.) The court held that this was sufficient to show that the plaintiff's corporation was in the control of officers who were carrying out the purposes of the other defendant company, and that their position in the controversy was one of

“hostility to the position assumed by the plaintiff. The classification of the parties according to the facts places the New Jersey company * * * as a party defendant in the controversy.”

A leading case in point is *Ashwander et al. v. Tennessee Valley Authority et al.* (1935), 297 U. S. 288, 56 S. Ct. 466, 80 L. Ed. 688, wherein Chief Justice Hughes reviewed the decisions saying, at page 319:

“In such a case it is not necessary for stockholders—when their corporation refuses to take suitable measures for its protection—to show that the managing board or trustees have acted with fraudulent intent or under legal duress. To entitle the complainants to equitable relief, in the absence of an adequate legal remedy, it is enough for them to show the breach of trust or duty involved in the injurious and illegal action. Nor is it necessary to show that the transaction was *ultra vires* of the corporation.

The illegality may be found in the lack of lawful authority on the part of those with whom the corporation is attempting to deal. Thus, the breach of duty may consist in yielding, without appropriate resistance, to governmental demands which are without warrant of law or are in violation of constitutional restrictions. The right of stockholders to seek equitable relief has been recognized when the managing board or trustees of the corporation have refused to take legal measures to resist the collection of taxes or other exactions alleged to be unconstitutional (*Dodge v. Woolsey*, 18 How. 331, 339, 340, 345; *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429, 433, 553, 554; *Brushaber v. Union Pacific R. Co.*, 240 U. S. 1, 10); or because of the failure to assert the rights and franchises of the corporation against an unwarranted interference through legislative or administrative action (*Greenwood v. Freight Co.*, 105 U. S. 13, 15, 16; *Cotting v. Kansas City Stockyards Co.*, 183 U. S. 79, 113). The remedy has been accorded to stockholders of public service corporations with respect to rates alleged to be confiscatory (*Smyth v. Ames*, 169 U. S. 466, 469, 517; *Ex parte Young*, 209 U. S. 123, 129, 130, 143). The fact that the directors in the exercise of their judgment, either because they were disinclined to undertake a burdensome litigation or for other reasons which they regarded as substantial resolved to comply with the legislative or administrative demands, has not been deemed an adequate ground for denying to the stockholders an opportunity to contest the validity of the governmental requirements to which the directors were submitting. See *Dodge v. Woolsey*, *supra*, at pp. 340, 345; *Greenwood v. Freight Co.*, at p. 15; *Pollock v. Farmers' Loan & Trust Co.*, *supra*, at pp. 433, 553, 554; *Brushaber v. Union Pacific R. Co.*, *supra*, at p. 10.

In *Smith v. Kansas City Title Co.*, 255 U. S. 180, a shareholder of the Title Company sought to enjoin the directors from investing its funds in the bonds of Federal Land Banks and Joint Stock Land Banks upon the ground that the Act of Congress authorizing the creation of these banks and the issue of bonds was unconstitutional, and hence that the bonds were not legal securities in which the corporate funds could lawfully be invested. The proposed investment was not large,—only \$10,000 in each of the classes of bonds described. *Id.*, pp. 195, 196. And it appeared that the directors of the Title Company maintained that the Federal Farm Loan Act was constitutional and that the bonds were ‘valid and desirable investments.’ *Id.*, p. 201. But neither the conceded fact as to the judgment of the directors nor the small amount to be invested,—shown by the averments of the complaint—availed to defeat the jurisdiction of the court to decide the question as to the validity of the Act and of the bonds which it authorized. The Court held that the validity of the Act was directly drawn in question and that the shareholder was entitled to maintain the suit. The Court said: ‘The general allegations as to the interest of the shareholder, and his right to have an injunction to prevent the purchase of the alleged unconstitutional securities by misapplication of the funds of the corporation, give jurisdiction under the principles settled in *Pollock v. Farmers’ Loan & Trust Co.* and *Brushaber v. Union Pacific R. Co.*, *supra.*’ *Id.*, pp. 201, 202. The Court then proceeded to examine the constitutional question and sustained the legislation under attack. A similar result was reached in *Brushaber v. Union Pacific R. Co.*, *supra.* A close examination of these decisions leads inevitably to the conclusion that they should either be followed or be frankly overruled. We think that they should be

followed, and that the opportunity to resort to equity, in the absence of an adequate legal remedy, in order to prevent illegal transactions by those in control of corporate properties, should not be curtailed because of reluctance to decide constitutional questions." (297 U. S. 288, 319-321.)

And in *Delaware & Hudson Co. v. Albany & Susquehanna R. R. Co.* (1909), 213 U. S. 435, the court said:

"* * * The attitude of the directors need not be sinister. It may be sincere. * * * In this case it was certainly determined. It continued until after this suit was brought. * * *"

(2) Where the Action Is Collusive or There Is Want of Equity.

It is well settled that when the action is a collusive one, brought to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction the action will be dismissed.

"Where the arrangement of the parties is merely a contrivance between friends for the purpose of founding a jurisdiction which otherwise would not exist, the device cannot be allowed to succeed."

Dawson v. Columbia Ave. Trust Co. (1905), 197 U. S. 178, 181, 49 L. Ed. 713.

The same rule applies where there is want of equity.

Levitan v. Stout (D. C. Ky., 1951), 91 Fed. Supp. 105, 111.

That is not the situation in the case at bar [R. 3], and the court so found [R. 267].

C. The District Court Erred in Holding That the Corporation Has Not Been Under the Domination of the Individual Defendants, or Any of Them, or Under the Control of Any Person or Persons Who Have Been Antagonistic or Hostile to the Financial Interests of the Corporation Since at Least as Early as March 25, 1953.

This holding must be answered in a practical and realistic manner. Important facts to be considered are that the individual appellees constituted the entire board of directors until that date [R. 4], appellee Lordan is still a member of the board of directors of the corporation and is president of the corporation [R. 144], appellee Ferrar is still general business manager, secretary and treasurer of the corporation [R. 266], all of the individual appellees were members of the executive committee of the corporation at all times after October 10, 1950, and so far as the record shows they are still members of said executive committee; they comprise the entire executive committee [R. 5], and the individual defendants own 42.1% of the stock of the corporation and are all members and general partners of The Beverly Hills Clinic, which benefited financially from the transactions alleged at the expense of the corporation [R. 60-61]. In fact, the partners of The Clinic own 91% of the stock of the corporation [R. 61].

In addition, the new directors were selected for the corporation by the individual appellees at the suggestion of the attorney for the individual appellees [R. 135], shortly after he had learned that the plaintiff was about to file his action [R. 133]. Since the new directors were selected by the individual appellees it is significant to know the extent to which the new directors were acquainted with the individual appellees.

Robert Denny, a new director, knew appellees Lordan and Browne, was "only vaguely acquainted" with appellees Brandsma and Langley, and was "not acquainted at all" with appellee Dietrich [R. 54].

Robert Clark, a new director, was acquainted with appellee Lordan, "but has only a nodding acquaintance with" appellees Browne and Langley, and "has never met" appellees Dietrich or Brandsma [R. 51-52].

Homer Burnaby, a new director, does not mention his acquaintanceship with appellee Lordan but says that he is "only vaguely acquainted with" appellees Browne, Langley, and Dietrich, and had "never even met" appellee Brandsma [R. 49]. Clearly, some one at the meeting must have known Mr. Burnaby.

Shirley Burden, the other new director, "is well acquainted with" appellee Lordan, "but is only vaguely acquainted with" appellees Dietrich, Browne and Langley and "although at one time" he "was fairly well acquainted with Maynard Brandsma, he has not been in Mr. Brandsma's company for about ten years" [R. 183].

Actually, Mr. Burden is not here significant because there is no indication in the record that he participated in any of the actions of the board of directors until after his return from Europe in August, 1953 [R. 183].

The other remaining director is appellee Lordan.

Furthermore, all of the appellees, the corporation and the individuals, were represented by one and the same law firm from early December, 1952, until after this action was filed, and they were the persons with whom appellant's attorneys had to deal [R. 9, 12, 125, 135, 142]. It is inconceivable that in their capacity as attor-

neys for the appellee corporation they could have taken a position adversary to their position as attorneys for the individual appellees.

D. The District Court Erred in Holding That the Corporation Was Not at the Time of the Commencement of This Action and Is Not Now Incapacitated From Bringing or Maintaining Suit Upon the Causes of Action Set Forth in Plaintiff's Complaint Herein and From Protecting Its Own Financial Interests.

It is fundamental that a corporation can act only through its authorized agents, its board of directors and officers. Where the board of directors and officers refuse to act for the corporation then it is, as a practical matter, incapacitated from acting.

Groel v. United Electric Co. (C. C. N. J., 1904),
132 Fed. 252, 262.

E. The District Court Erred in Holding That the Within Action Is Not One Between Citizens of Different States and That the Requisite Diversity of Citizenship Between the Plaintiff on the One Hand and the Defendants on the Other Did Not Exist at the Time of the Commencement or the Within Action and Does Not Now Exist and That It Did Not Then and Does Not Now Have Jurisdiction Over the Subject Matter.

When the appellee corporation remains properly aligned as a defendant, as was done in the complaint, and as it should have been on the basis of established law, as set forth above, there is complete diversity of citizenship with a citizen of Illinois as plaintiff and with citizens of California as defendants. This being true, and the other necessary jurisdictional facts being present as they are here, the court had jurisdiction over the subject matter.

**F. The District Court Erred in Dismissing the
Within Case for Lack of Jurisdiction Over the
Subject Matter.**

With all necessary jurisdictional facts present, as in paragraph "E" immediately above, it was error for the District Court to dismiss the action for lack of jurisdiction over the subject matter.

Respectfully submitted,

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Attorney for Appellant.

THOMAS DODD HEALY,

Of Counsel.

No. 14349.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE R. CARR,

Appellant,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P.
LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE,
ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS
J. FERRAR,

Appellees.

APPELLEES' BRIEF.

FILED

NOV 10 1954

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I.

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No. 14349.

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Appellees.

APPELLEES' BRIEF.

Preliminary Statement.

Appellee Beverly Hills Corporation is the Corporation of which appellant was and is a stockholder and allegedly upon whose behalf plaintiff-appellant filed his Complaint [R. 3, 265]. The individual appellees Maynard Brandsma, Francis E. Browne, Robert W. Langley, and Harry F. Dietrich formerly were members of the Board of Directors of said Corporation and appellee John F. Lordan was and is an officer and a member of the Board of Directors of said Corporation [R. 4, 266]. Appellee Ross J. Ferrar was and is an officer of said Corporation but has never been a director [R. 266]. All of the

individual appellees are doctors of medicine except appellee Ferrar, who is a registered pharmacist [R. 5, 105].

The Complaint herein alleges that the individual appellees negligently and fraudulently managed the affairs of appellee Corporation during 1951 and 1952 in several particulars and seeks a judgment against the individual appellees in favor of appellee Corporation for money damages, for an accounting and for plaintiff's attorneys' fees and costs [R. 7-26]. All these charges were specifically denied in affidavits filed in connection with the motions hereinafter mentioned [R. 90-97, 101-120, 223-241], but the details of such denials and attendant explanations will not be herein set forth or discussed because they are not relevant to the question of jurisdiction which is the sole issue involved on this appeal.

Appellee Corporation filed a motion to dismiss the complaint herein for failure to state a claim upon which relief can be granted or, in the alternative, to require plaintiff to post security pursuant to Section 834(b), California Corporations Code [R. 46]. The individual appellees made a similar motion, and in addition moved to strike the complaint as sham, false, vexatious and frivolous [R. 88]. The trial court, noting that it "probably" lacked jurisdiction over the subject matter of the action and hence jurisdiction to entertain said motions, dismissed the motions of appellees with leave to renew the same if and when it should be determined that the court had jurisdiction over the subject matter [R. 253].

Appellee Corporation and the individual appellees thereafter filed separate motions to dismiss the complaint for lack of jurisdiction over the subject matter of the action and, in the alternative, renewed their earlier motions [R.

254, 257]. After submission of briefs and oral argument, the District Court made and filed Findings of Fact and Conclusions of Law [R. 264-270] and its Judgment dismissing the action "for lack of jurisdiction over the subject matter" of the action [R. 271-272]. Thereafter appellant duly perfected the within appeal from said judgment of dismissal.

Upon motion duly made by appellees, and upon stipulation of appellant, this Court by its order on October 8, 1954, authorized all appellees to join in filing a single brief.

Jurisdictional Statement.

Appellant alleged in his complaint that the United States District Court had jurisdiction over the subject matter of the action because the amount in controversy exceeded \$3000.00, exclusive of interest and costs, and the suit was between citizens of different states [R. 2-3], and it is a fact that at all times here pertinent appellant was a citizen of Illinois; appellee Corporation was duly organized under the laws of the State of California and was a citizen of that State; and all the individual appellees were citizens of the State of California [R. 265].

Appellant contends (Op. Br. p. 2) that the District Court had jurisdiction under Title 28, U. S. Code, Section 1332, since (he claims) the controversy is between citizens of different states and exceeds the jurisdictional minimum amount of \$3,000.00. However, after going fully into the facts, the District Court realigned appellee Corporation with appellant as a plaintiff and hence determined that the requisite diversity of citizenship did not exist [R. 268-269].

Statement of the Case.

Inasmuch as we do not consider that appellant's statement of the case either correctly or adequately presents the facts which are pertinent to his appeal, appellees herewith present their own statement of the case as is allowed by Rule 18(3) of the Rules of this Court.

The sole issue before this Court is whether or not the District Court correctly determined that it did not have jurisdiction over the subject matter of the within action. Appellant in his Opening Brief devotes practically all of his statement of the case to a discussion of matters which relate solely to the alleged "merits" of the action but which clearly are immaterial to a determination of the jurisdictional issue now before this Court. All of appellant's charges have been denied in affidavits filed below by or on behalf of the appellees, and appellees invited and welcomed a full examination of the "merits" of plaintiff's claim in the Court below. In fact they twice sought to have the District Court determine these issues on motions to dismiss for failure to state a claim upon which relief could be granted. The trial court determined, however, that it was without jurisdiction to hear those motions to dismiss, and the case is now before this Court solely upon the jurisdictional issue. Hence, we shall confine our brief to the facts relating thereto.

Plaintiff became a stockholder in appellee Corporation in June, 1950, when he purchased 400 shares of common stock and he was such a stockholder at the date the action was commenced. His stock holding represents 1.6% of the total issued and outstanding shares of the common stock of appellee Corporation [R. 265], and his cost of the stock was \$400.00 [R. 234]. No other stock-

holders of appellee Corporation joined in the prosecution of the within action [R. 2].

Appellant's son-in-law, Dr. Omar Fareed, is now and at all times mentioned in the Complaint was also a small stockholder of appellee Corporation, and was previously a partner in the Beverly Hills Clinic [R. 116, 117]. Donald A. Fareed, brother of the said Dr. Omar Fareed, was the attorney for appellee Corporation and the Beverly Hills Clinic and was secretary of the said Corporation from December 6, 1950, to December 4, 1952 [R. 116, 220, 225], and was and is a small stockholder in said Corporation [R. 226]. Donald A. Fareed supervised and advised both said Corporation and said Clinic concerning all of the alleged transactions described in the complaint herein, with the single exception of the matter described in the third cause of action of said complaint [R. 117]. Dr. Omar Fareed and Donald A. Fareed were fully informed of all material matters relating to said Corporation and said Clinic, and communicated at length with appellant concerning said matters throughout the periods described in said complaint [R. 221, 234, 235]. By a letter dated December 1, 1952, the said Donald A. Fareed was formally designated by appellant as one of his attorneys in connection with appellant's alleged charges against the individual appellees. [R. 234-235.]

The true facts respecting the transactions alleged in the complaint herein have never been concealed from any stockholder of appellee Corporation and such transactions as occurred were entered into with the full knowledge, or means of knowledge, and acquiescence of all stockholders [R. 118]. No objection to any of said transactions was ever made by any stockholder of appellee Corpora-

tion, or by anyone else, until early December of 1952, when one of appellant's counsel made certain objections and requested certain information from officers of appellee Corporation [R. 118, 122]. In connection with such requested information, all of said Corporation's books and records were promptly made available to appellant's counsel, but said attorney refused to examine or inspect said books and records. [R. 122-125.]

Between early December, 1952, and the latter part of April, 1953, counsel made available for examination and copying to appellant's counsel numerous documents and papers of appellee Corporation and the Clinic [R. 126-129, 132-134] and counsel agreed to have the firm of Haskins & Sells, certified public accountants, make a complete audit of all transactions between appellee Corporation and said Clinic [R. 129-131], which was promptly done, and a copy of said audit report was furnished to appellants' counsel on or about April 18, 1953 [R. 137-138]. Said audit report, covering the period from March 7, 1950 (the date of the first recorded transaction between said Corporation and said Clinic), until February 28, 1953, verified and supported all transactions between said Corporation and said Clinic, except for several items of minor monetary amounts [R. 138-140].

On March 25, 1953, four new members of the board of directors of appellee Corporation were elected and took office, replacing on said Board appellees Brandsma, Browne, Langley, and Dietrich [R. 90, 94, 101, 110, 134, 135]. None of said new board members was a stockholder of said Corporation or a partner of the Beverly Hills Clinic, but each was a well-known business man, to wit: Robert Denny, President of Grand Central Air-

craft Co.; Robert Clark, President of Robert H. Clark Co.; Homer Burnaby, President of Sierra Lumber Company and Vice-President of Sun Lumber Company; and Shirley Burden, partner of the firm of William A. Burden & Company and civic leader [R. 48, 51, 53, 134, 135, 182]. Appellant's counsel was promptly notified of the names of the new members of said board of directors [R. 137], and was informed in writing on March 25, 1953, that if "there are any possible corporate claims which you think should be given attention, there is now an independent Board of Directors of the Corporation which will be available to give careful consideration to any matters when submitted to you" [R. 137]. No claims of any kind have ever been made by appellant or his counsel to said new board of directors [R. 48, 51, 55, 182].

On April 30, 1953, at about noon, appellant delivered to appellee Ferrar a copy of the complaint herein, attached to which was a "demand," addressed to the board of directors of said Corporation and dated April 27, 1953, that said Corporation "join" in prosecuting the within action against the individual appellees [R. 44, 45, 98, 99]. The then counsel for said Corporation was thereupon informed by appellant's counsel that said complaint was to be filed in court that same afternoon [R. 99]. Said Corporation's counsel stated to appellant's counsel that he would call a meeting of the board of directors as soon as possible that afternoon to consider the claims of appellant, to which appellant's counsel replied that the complaint would be filed that said day "regardless of action by the Board of Directors" [R. 99, 100]. The complaint was, in fact, filed that same afternoon on April 30, 1953 [R. 140].

The hereinabove mentioned Donald A. Fareed represented the Corporation throughout the period now complained of by appellant, and the law firm of Gibson, Dunn & Crutcher did not begin representing appellee corporation until December 4, 1952 [R. 127, 142]. On May 4, 1953, as soon as the complaint and claims of appellant were brought to the attention of the new board of directors of said Corporation, and upon the suggestion of Herbert F. Sturdy of Gibson, Dunn & Crutcher that said Corporation might desire to secure new legal counsel, said new board selected and retained the law firm of Latham & Watkins to represent said Corporation herein [R. 56, 142]. Since that date Gibson, Dunn & Crutcher has not represented said Corporation, but has been retained to represent and has represented the individual appellees herein [R. 142].

The new Board of Directors of appellee Corporation immediately began, through its new counsel, a complete and independent investigation of the facts and the law involved in the claims set forth in the complaint herein [R. 56-57]. Said investigation continued through the course of four or five weeks [R. 58]. During said investigation, appellee Corporation's counsel, on June 5, 1953, made a written request upon appellant's counsel for any information appellant had to support his charges [R. 80-82]. Almost three weeks later appellant's counsel replied to said request but furnished no such information [R. 83-85]. Counsel for said Corporation immediately replied to appellant's counsel, repeating the prior request for said information, and suggesting a conference to discuss the matter [R. 86-87]. No reply having been received to this last letter, counsel for appellee Corporation tele-

phoned to appellant's counsel on June 30, 1953, and again suggested such a conference [R. 76].

A conference was finally held between attorneys for appellant and appellee Corporation on July 10, 1953 [R. 76]. Said Corporation's counsel at this conference related fully the results of its investigation of the claims of appellant and its conclusions and again requested information or proof to support said claims from appellant's counsel [R. 76, 192, 193]. Except for several matters of minor importance, appellant's counsel did not furnish or relate any of said requested information [R. 76], and has not furnished any such information to this date [R. 76, 197].

Meanwhile, the board of directors of appellee Corporation met in a special meeting on June 24, 1953, to receive and consider its counsel's written report of its investigation of the facts and the law relating to appellant's claims herein [R. 58]. After a thorough and careful analysis and discussion of each of said claims, the board of directors (except Dr. John P. Lordan, who did not participate in the discussion and did not vote) adopted a detailed resolution to the general effect that since the claims of appellant were not supported by the facts, and the prosecution of appellant's claims would not be to the best interests of said Corporation, that the appellee Corporation not join in or prosecute the action instituted by appellant but take whatever steps were necessary and possible to terminate said litigation with the least possible expense to said Corporation [R. 63-73].

Another meeting was held by the board of directors of appellee Corporation on October 15, 1953, in which there was considered and discussed matters which had occurred

in the within litigation since their prior meeting [R. 207-217]. At the conclusion of this meeting said board of directors (except Dr. Lordan, who did not participate and did not vote) adopted a detailed resolution reaffirming its prior resolution of June 24, 1954 [R. 214-217].

Four members of the board of directors of appellee Corporation (Messrs. Burnaby, Denny, Clark, and Burden) are not charged with having anything to do with the alleged transactions complained of by appellant. All of them have high reputations in Los Angeles business and civic circles [R. 54]. None of these gentlemen, except perhaps Mr. Burden, even knows all of the individual appellees [R. 48, 49, 51, 52, 54, 183]. There has been no attempt by any individual appellee, or by anyone else, to influence the present Board of Directors of appellee Corporation in the exercise of the board's judgment and discretion [R. 49, 52, 57, 58, 183].

In determining that the prosecution or maintenance of appellant's suit herein is not to the best financial interests of appellee Corporation, the present Board of Directors has acted in good faith and has exercised its independent judgment, after a full and complete investigation of the facts relating to appellant's claims herein [R. 49, 51, 52, 57, 58, 183, 184], and after unsuccessfully attempting to secure from appellant information supporting said claims [R. 76, 80-87, 197].

Appellee Corporation is now in the process of a voluntary winding up and dissolution upon the written consent of over 90% of its stockholders [R. 128]. The building, which was said Corporation's principal asset, has been sold to a third party for \$1,430,000.00 for a profit of over \$157,000.00 to said Corporation, and said Corpora-

tion's remaining equipment was sold to the Beverly Hills Clinic for \$97,673.34 [R. 127, 128, 141]. From these sales the stockholders of said Corporation (including appellant who loaned \$20,000.00) have been repaid the full amount of their loans of \$727,095.00 made to the Corporation, plus interest thereon, and it is anticipated that at the close of dissolution said Corporation will return to its stockholders the full purchase price paid for their shares of stock plus a profit of about 75% of said purchase price, unless the cash remaining for distribution is dissipated in the costs and expenses of this litigation [R. 141]. Any cash recovery which appellee Corporation might obtain through appellant's efforts in this action would automatically be disbursed in cash by the dissolving corporation to its stockholders. Hence, in an endeavor to quickly terminate this obviously useless and unnecessary litigation, which no one favors except the appellant, the individual appellees, without acknowledging any liability, offered to pay to the appellant his full pro rata share (a few hundred dollars) of the full amount claimed by him for the Corporation in the complaint. Appellant refused such offer as being "unrealistic" [R. 143-144].

Appellant concedes, and the District Court found that appellant brings the within action as a derivative action in the right of and on behalf of appellee Corporation and seeks to recover a judgment in favor of said Corporation [R. 265]. Appellee Corporation is the real party in interest herein and an indispensable party [R. 265]. None of the majority of the present board of directors of appellee Corporation, to wit, Messrs. Burnaby, Clark, Denny and Burden, is or has been under the domination or control of any of the individual appellees or of any person

or persons who have been antagonistic or hostile to the financial interests of said Corporation [R. 49, 51, 52, 57, 92, 96, 103, 108, 112, 119, 183, 267, 268] and the Corporation was not at the commencement of said action and is not now incapacitated from bringing or maintaining suit upon any cause of action which may exist in its favor or from protecting its own financial interests [R. 268].

Under all of the circumstances the trial court determined that although designated as a defendant by appellant, for the purpose of determining whether the necessary diversity exists, the appellee Corporation must be realigned as a plaintiff [R. 268]. The result of such realignment was that the necessary diversity of citizenship did not exist and accordingly the court dismissed the action for lack of jurisdiction [R. 269, 272].

Summary of Argument.

Appellant's argument (Op. Br. pp. 14-35) contains numerous subdivisions, but his basic disagreement with the trial court's decision is really only two-fold:

First: Appellant claims that Finding of Fact No. 10 is erroneous. (Op. Br. pp. 32-34.) Finding No. 10 is to the effect that the defendant Corporation, for whose benefit the action is being brought by plaintiff, has *not* been under the domination of the individual defendants herein or any of them or under the control of anyone else who has been antagonistic or hostile to the financial interests of the Corporation at any time since at least as early as March 25, 1953 (*five weeks prior to the commencement of the within action*), that the Corporation was *not* at the time of the commencement of the within action incapacitated

tated from bringing or maintaining suit upon the alleged causes of action set forth in the Complaint, and that the Corporation was *not* at the time of the commencement of the action incapacitated from protecting its own financial interests. [Finding No. 10, R. 267-268.]

Second: Appellant claims that the legal theory upon which the Court dismissed the Complaint, to wit, that the appellee Corporation must be realigned as a plaintiff under the factual circumstances disclosed by the record, is erroneous. (Op. Br. pp. 15-31.)

With respect to the first issue, appellees' position is that Finding No. 10 is fully supported by the evidence, for an independent Board of Directors was in control of the corporation for more than a month before the complaint was filed; that four of the five members of said new Board are outstanding business men who are not involved in any way in the alleged wrongdoings described in the complaint; that said new Board has exercised its independent business judgment and determined that it would not serve the best interests of the Corporation to prosecute or join in appellant's action; and that the Corporation is fully able to protect its own financial interests. (Argument, Point I.)

With respect to the second issue, appellees contend that the District Court properly applied correct legal principles to realign the parties according to the true facts and then to dismiss the action for lack of diversity jurisdiction. (Argument, Point II.)

ARGUMENT.

The determination of this appeal depends primarily upon the question of whether or not appellant can overturn the trial court's Finding of Fact No. 10. Hence, we will first show the accuracy of the questioned finding, and thereafter will demonstrate the correctness of the trial court's legal conclusions from that finding, although appellant in his Opening Brief treated these subjects in the reverse order.

I.

Appellant Failed to Meet the Burden of Showing Facts Sufficient to Demonstrate the Existence of Jurisdiction, and the Trial Court's Finding No. 10 to the Effect That the Appellee Corporation Has Not Been Under the Domination of Anyone Antagonistic or Hostile to the Financial Interests of the Corporation, Nor Has It Been Incapacitated From Maintaining the Action, Was Clearly Correct.

A. Introduction.

Strangely enough, although it is clearly the heart of the trial court's decision and hence necessarily the primary hurdle which appellant must overcome on this appeal, appellant withholds his attack on Finding No. 10 until the very end of his brief, and then devotes only about two pages to that attack. (Op. Br. pp. 32-34.) A reading of those pages in conjunction with the full record before the trial court, will demonstrate beyond question the correctness of the trial court's tenth finding.

It is well settled, of course, that where jurisdiction is questioned, the party invoking that jurisdiction has the

burden of demonstrating facts from which the existence of jurisdiction may be shown.

McNutt v. General Motors Acceptance Corp.
(1936), 298 U. S. 178, 56 S. Ct. 780, 80 L. Ed. 1135;

Royalty Service Corp. v. City of Los Angeles (9th Cir., 1938), 98 F. 2d 551, 554.

The record in this case shows beyond question that appellant wholly failed to meet the burden of showing facts sufficient to support jurisdiction.

B. The Complaint and the Record Fail to Show That the Corporation Was or Is Incapacitated From Suing Upon the Alleged Claims Set Forth in Plaintiff's Complaint or From Protecting Its Own Financial Interests.

Let us first examine appellant's Complaint which, incidentally, does not even allege that the appellee Corporation was under the domination of the alleged wrongdoers or in any way incapacitated to protect its own interests at the date the action was commenced.

In his Complaint, appellant affirmatively pleaded that four of the five members of the Board of Directors were replaced by new personnel on March 25, 1953 [R. 11], which was *more than five weeks prior to the commencement of the within action* on April 30, 1953. The Complaint admits that appellant has never demanded or requested that the Corporation take action against anyone to recoup the alleged losses [R. 11]. The record is devoid of any evidence whatsoever that any demand for relief was made upon the new Board, save and except the "demand" attached to the Complaint [R. 44], which was left with the business manager of the Corporation only

a few hours prior to the filing of the action. Appellant's use of this "demand" clearly shows that appellant was not acting in good faith herein for at least three reasons: (1) the "demand" was not that appellee Corporation institute or take action against the individual appellees, but merely that the Corporation "join" appellant in prosecuting the action; (2) although immediately requested by the Corporation's counsel, the attorney for appellant refused to withhold the filing of the action for even one day to enable the new Board of Directors to convene and consider the "demand," and (3) appellant knew, of course, that if the Corporation had joined with appellant as "demanded," *the very diversity upon which appellant relies would have been extinguished*, since appellee Corporation is a citizen of the same state as all of the individual appellees.

Further, the Complaint fails to allege that the new Board of Directors has acted improperly in any way, or that it refused to bring the action, or that it abused its discretion in not bringing or maintaining an action. Under controlling California authorities it is clear that because of the absence of such allegations, the Complaint wholly failed to state a claim upon which relief could be granted. (See: *Findley v. Garrett* (1952), 109 Cal. App. 2d 166; 240 P. 2d 421.) (Hearing denied by California Supreme Court.)

The evidence is overwhelming that a majority of the new Board (four out of five) was in fact entirely independent and not under the control of the individual appellees or of anyone else. Appellant has never seriously challenged this fact. In his Complaint, appellant ventures the bare conclusion that the four new Board members

“were friendly to, and partisans of the then Board of Directors” [R. 11], but appellant offered no evidence to prove even this rather mild charge. The effect, if any, of these conclusory allegations was totally destroyed by the clear-cut, unequivocal statements under oath by each of the four new Board members in which they denied that they were “friendly to” or “partisans of” the former Board, or were in any manner controlled or dominated by members of the old Board [R. 48-58, 183-184]. Although given ample opportunity [R. 264] to do so, appellant failed to challenge or rebut in any way the truthfulness of such sworn statements.

The independence of the new Board of Directors is further shown by the fact that (a) four of its five members are outstanding businessmen who had no prior business relations with appellees and who are not alleged to have been involved in any way in the alleged wrongful transactions described in the Complaint [R. 48, 51, 53, 134, 135, 183]; (b) as soon as appellant’s “demand” and Complaint were brought to the attention of the new Board, it immediately retained new legal counsel and directed counsel to make a complete investigation of all the facts relating to appellant’s charges [R. 56, 58]; (c) it sought unsuccessfully to get from appellant any evidence to support such charges [R. 76, 80-82, 88-89, 197]; (d) it held two special Board meetings where it received and considered thoroughly its counsel’s report upon investigation of appellant’s charges [R. 58-73, 207-217]; and (e) it determined in good faith, and only after all facts were exposed and studied, that it would not serve the interests of the Corporation to have the action prosecuted or maintained [R. 63-73, 208-217].

Upon these facts and the entire record, it seems clear that the trial court correctly found that for more than a month prior to the commencement of the action and at the time of the commencement of the action, the Corporation was *not* under the control of any person or persons who were antagonistic or hostile to the financial interests of the Corporation, and that the appellee Corporation likewise was *not* at the time of the commencement of the action in any way incapacitated from bringing the within suit or from otherwise protecting its own financial interests.

C. Appellant Has Failed to Support His Attack Upon the Trial Court's Findings Upon Which the Court Based Its Determination That It Lacked Jurisdiction.

Let us analyze briefly the appellant's attack on Finding No. 10.

(1) Appellant notes that one of the appellees (Dr. John P. Lordan) is still a member of the five-man Board of Directors and is President of the Corporation, and that another appellee (Ross Ferrar) is still its business manager, Secretary and Treasurer, and that all of the individual appellees were and are members of the Corporation's Executive Committee. (Op. Br. p. 32.) But just how or in what manner these facts challenge the propriety of Finding No. 10 is not shown by appellant. To the contrary, the sole and overwhelming evidence before this Court is that the present independent Board of Directors has exclusively managed the Corporation since March of 1953, and the governing body of the Corporation is, of course, its Board of Directors (Cal. Corp. Code §800).

(2) Appellant next states that the individual appellees own 42.1% of the stock of the Corporation. (Op. Br. p. 32.) We fail to see how this fact aids appellant's position, since it affirmatively shows that the individual appellees do *not* own a majority of the stock.

(3) Appellant claims that "the new directors were selected for the corporation by the individual appellees at the suggestion of the attorney for the individual appellees." (Op. Br. p. 32.) While appellant apparently intends to be critical of this method of selection, he fails to suggest any other means and we do not know any better way of obtaining a new and independent board than to have the representatives of the Corporation, and its attorneys, request leading businessmen of the city to take charge of the corporate affairs [R. 134].

(4) Appellant further states that since the new Directors were selected by the individual appellees, "it is significant to know the extent to which the new directors were acquainted with the individual appellees." (Op. Br. p. 32.) Appellant then proceeds to point out that almost none of the new Directors had any real acquaintanceship with the old Directors (Op. Br. p. 33). This fact, of course, tends to prove the independence of the new Board, and refutes the charge made in the Complaint that the new members of the Board "were friendly to, and partisans of, the then Board of Directors" [R. 11]. Appellant's change of position, no doubt, was made necessary by the clear and undisputable evidence presented below that the new members of the Board were in fact completely independent of the old members.

(5) Lastly, appellant states that the Corporation and the individual appellees were represented by the same

attorneys from December, 1952, until after the action was filed (Op. Br. p. 33). But it is clear that the law firm of Gibson, Dunn & Crutcher did not represent the Corporation or any of the appellees until December, 1952, long *after* the various acts alleged in the Complaint were supposed to have occurred, and appellant nowhere suggests that counsel who took over *after* the alleged wrongful acts did not represent it and its stockholders fully, fairly and properly at all times. The record shows that such new counsel was most receptive to every suggestion of appellant, had a special audit made for his benefit, invited appellant to submit his claims to the new Board of Directors, and cooperated in every way in trying to ascertain whether any of appellant's charges was valid. Bearing in mind that the new counsel had not represented the Corporation at the time of the occurrence of the alleged wrongful acts by the old Directors, there was no reason why they could not represent the Corporation while appellant's claim was being explored. *Nor is there the slightest suggestion that appellant ever requested the intervention of new counsel.*

We submit, therefore, that the court's finding, that at the time of the commencement of the within action, the Corporation was not under the control of anyone hostile to its financial interest and that it was able to take care of its own business affairs and to protect its own interests, was not only amply supported by the evidence, but is actually not challenged by anything in the record and was in fact the only finding which could have been made on the evidence presented below. Certainly the appellant has not shown that the finding is clearly erroneous within the meaning and intent of Rule 52(a) of the Federal Rules of Civil Procedure.

II.

Under the Circumstances Disclosed by the Record the Trial Court Properly Realigned the Appellee Corporation in Its True Position as Plaintiff, and There Then Being No Diversity, the Action Was Properly Dismissed for Lack of Jurisdiction.

A. Appellant Concedes the Correctness of the Several Underlying Rules of Law Relied Upon by the Trial Court.

Appellant concedes the basic rules of law relied upon by the trial court in dismissing his complaint, and thus has narrowed considerably the issue to be determined by this Court. For example, appellant has conceded in his Opening Brief that:

(1) "The federal courts possess only such jurisdiction as is conferred upon them by the constitution and the laws of the United States." (Op. Br. p. 12.)

(2) The test of jurisdiction "must be determined with reference to the attitude of the case at the time of the filing of the action." (Op. Br. p. 12.) In other words, jurisdiction which exists at the time of the filing of an action cannot be ousted by subsequent events any more than can jurisdiction be conferred by a factual situation which existed more than a month prior to but not at the time of the filing of the action.

(3) "In a stockholder's derivative action the stockholder is asserting a cause of action belonging to his corporation." The corporation is the "real party in interest" and "an indispensable party" and "the citizenship of the corporation must be considered in aligning the parties for the purpose of testing jurisdiction." (Op. Br. p. 16.)

(4) Where federal jurisdiction "is invoked upon the basis of diversity of citizenship, the Court is not bound by the arrangement in which the pleader has placed the parties, *but will look beyond the pleadings and arrange the parties according to the facts.*" (Op. Br. p. 12.)

B. It Is Only When the Corporation Is in "Antagonistic Hands" That the Corporation Can Properly Be Aligned as a Defendant in Determining if Diversity of Citizenship Exists.

The law on the subject of the proper alignment of parties in stockholders' derivative suits has been carefully and thoroughly discussed in the case of *Smith v. Sperling* (S. D. Cal. 1953), 117 Fed. Supp. 781. That is a decision by the same District Judge who decided the within case and little can be said to add to the law on the subject as therein expressed. In this connection it should be noted that although appellant is aware of the *Smith* case (Op. Br. pp. 15-16), *nowhere in his brief does he attack or make any attempt to differentiate or criticize that decision*, despite the fact that it expresses the views of the trial court in the within case and, on the law, represents an identical decision with this one. Hence, we respectfully refer this Court to the decision in *Smith v. Sperling, supra*, confident that it represents a full and correct statement of the law and amply supports the trial court's dismissal for lack of jurisdiction in the within action.

The main, if not the sole, difference of opinion between the parties upon the legal issues here involved, may be summarized as follows: Appellant's position is that a mere refusal to bring suit by the Board of Directors of a corporation makes the corporation so opposed to the

object sought by the plaintiff-stockholder that the corporation may be aligned as a party defendant for diversity purposes. On the other hand, it is appellees' position that to justify alignment of the corporation and the individual appellees on the same side, it must be affirmatively shown that the corporation is "in 'antagonistic hands'—*i. e.*, so dominated that it is incapacitated to act in keeping with its own financial interests." (*Smith v. Sperling, supra*, p. 801.)

In the overwhelming number of cases which have considered this problem and which have aligned the corporation as a defendant, the corporation has, in fact, been under the domination or control of, or has participated with, the officers or board of directors whose fraudulent or illegal actions the suit seeks to redress. See, for example, *Doctor v. Harrington*, 196 U. S. 579, 25 S. Ct. 355, 49 L. Ed. 606; *Venner v. Great Northern Ry.*, 209 U. S. 24, 28 S. Ct. 328, 52 L. Ed. 666; *Cutting v. Woodward* (9th Cir. 1918), 255 Fed. 633, all of which cases are cited by appellant in his Opening Brief.

Appellant relies heavily upon the "leading case" of *Doctor v. Harrington, supra*. This decision is thoroughly analyzed in *Smith v. Sperling, supra*, where it is pointed out that the court in the *Doctor* case determined the jurisdictional facts solely upon the allegations of the complaint, which included the statement that, "The board of directors of said corporation is under the absolute control and domination of the defendant John J. Harrington [who] by reason of having possession of a majority of the capital stock . . . likewise controls the action of the stockholders." (196 U. S. at p. 582, 25 S. Ct. at p. 356.) From these allegations, the court concluded that the cor-

poration should not be aligned with the plaintiffs in determining diversity jurisdiction.

However, as appellant readily concedes (Op. Br. p. 17), the true rule in determining jurisdiction based upon diversity of citizenship in this type of case is set forth in the *Removal Cases*, 100 U. S. 457, 469, 25 L. Ed. 593, 598, where the court said:

“Under the old law the pleadings only were looked at, and the rights of the parties in respect to a removal were determined solely according to the position they occupied as plaintiffs or defendants in the suit. . . . Under the new law the mere form of the pleading may be put aside, and the parties placed on different sides of the matter in dispute *according to the facts.*” (Emphasis supplied.)

As to the other decisions relied upon by appellant, most of them are analyzed and discussed by the court in *Smith v. Sperling, supra*, and this conclusion reached (117 F. Supp. 804):

“Only in cases where it appeared that the plaintiff-stockholder’s corporation was ‘in antagonistic hands,’ *Koster v. (American) Lumbermens Mutual Co., supra*, 330 U. S. at page 523, 67 S. Ct. at page 831, has the Court found that ‘difference or collision of interest’ between stockholder and corporation as to ‘the matter in controversy’ *City of Dawson v. Columbia Trust Co., supra*, 197 U. S. at page 181, 25 S. Ct. at page 421, which precludes alignment of the corporation with the stockholder in determining diversity jurisdiction.

“And only in cases where it appeared that the plaintiff-stockholder’s corporation was ‘dominated and controlled’ by the alleged wrongdoers, *Koster v. (American) Lumbermens Mutual Co., D. C. E. D.*

N. Y. 1945, 64 F. Supp. 595, 596, and so 'made to act * * * subservient to some illegal purpose,' *Doctor v. Harrington, supra*, 196 U. S. at page 587, 25 S. Ct. at page 357, or to engage in 'the same illegal and fraudulent conduct,' *Venner v. Great Northern Ry., supra*, 209 U. S. at page 32, 28 S. Ct. at page 329, has the Court found the corporation to be 'in antagonistic hands.' "

But what is the nature of the "antagonism" which must be shown to exist in order to align the corporation as a defendant in a stockholder's derivative action? Appellant contends that a *mere refusal* of the corporation to sue makes the corporation "antagonistic" for this purpose (Op. Br. p. 27). Admittedly, such language may be found in some decisions cited by appellant, notably *Schmidt v. Esquire, Inc.* (7th Cir. 1954), 210 F. 2d 908, and *Ashwander, et al. v. Tennessee Valley Authority* (1936), 297 U. S. 288, 56 S. Ct. 466, 80 L. Ed. 688. However, an examination of these two cases will show that they are not authority for appellant's contentions. In each case the statement quoted by appellant is pure *dictum*. Thus the statement twice quoted by appellant from the *Schmidt* case (Op. Br. pp. 21-22, 27-28) is immediately followed in the opinion by the statement that it need not consider further the plaintiff's theory of alignment since the District Court had correctly ruled that under the circumstances of the case, the citizenship of the corporation was immaterial for the purpose of testing diversity. (210 F. 2d at p. 912.) Actually the court found that the cause of action involved was not in the corporation at all but was in its trustee in bankruptcy and the complaint was therefore dismissed by the District Court for failure to state a claim, and this ruling was affirmed by the Court of Appeals.

So also in the *Ashwander* case, upon which appellant so heavily relies. An examination of that case will show that it did not involve the problem of realignment nor of diversity, but solely the question of whether or not the plaintiff's stockholder had a right to bring the derivative action at all.

Appellant also relies on *Cutting v. Woodward* (9th Cir., 1918), 255 Fed. 633, 635 (Op. Br. pp. 25-26). The facts in that case were not at all like those herein involved, for there (1) the trial court found that the individual defendant and the corporation had engaged in *actual fraud* during a period when the individual defendant had virtual control of the majority of the Board of Directors, and "they were ever ready to do his bidding"; and (2) the defrauding individual defendant continued in control of the corporation and hence the all important element of the independent Board and counsel *intervening* between the period when the wrongful acts were alleged to have been committed and the commencement of the derivative action, was lacking.

We think that the true tests in stockholder's derivative suits are correctly set out in the *Smith v. Sperling* case.

First: A refusal to sue based upon a mere difference of opinion (which is all we have in the case at bar) is *not* sufficient to show "antagonism" or "hostility" (117 Fed. Supp. 802).

Second: The mere fact that the new Board disagrees with the stockholder and hence may in one sense be deemed to be "hostile" or "antagonistic" to the *stockholder*,

so that *his* demand would be "futile," is not controlling. The cause of action involved belongs to the Corporation. Hence, the court quite properly concluded (117 Fed. Supp. 804):

"Thus in each case the determinative fact is not whether the directors controlling the corporation are antagonistic to the suing stockholder, but whether those in control are shown to be antagonistic to the financial interests of the corporation."

Lastly: The court properly determined that a mere disagreement with the Board of Directors is insufficient to give the stockholder the right to invoke federal jurisdiction, the trial court saying (117 Fed. Supp. 803):

"A mere argument then, or even a heated debate, between a shareholder and his corporation over the advisability of bringing suit is not a 'controversy' as that term is employed in §2 of Article III of the Constitution. But even if it were, it is not 'the matter in controversy' with respect to which the court is duty-bound to align the parties to the action for the purpose of ascertaining whether requisite diversity of citizenship exists. 28 U. S. C., §1332."

The above-defined rules implement the wise constitutional (U. S. Const., Art III, Sec. 2) and statutory (28 U. S. C., Sec. 1332) prohibition against extension of the federal power to controversies that properly belong in the state courts, and assure that the time and facilities of the already overworked federal courts shall be preserved for the determination of matters where there truly is federal jurisdiction. (See *Healy v. Ratta* (1934), 292 U. S. 263, 54 S. Ct. 700, 78 L. Ed. 1248; *City of*

Indianapolis v. Chase National Bank (1941), 314 U. S. 63, 62 S. Ct. 15, 86 L. Ed. 47.)

For all of which reasons we submit that the tests set out in the *Smith v. Sperling* case were correct and that when applied to the findings of the trial court, the alignment of the Corporation in its true position as plaintiff was necessary and proper.

In closing this Point II, we also respectfully direct this Court's attention to the fact that whatever may be the law in other states, it is well settled in California that where, as here, an independent Board of Directors in the honest exercise of its best judgment determines not to commence or maintain an action, a stockholder may not usurp the discretionary powers of the Board by commencing a derivative action, and that the determination of the matter by the new and independent Board of Directors is an absolute bar to any action by the shareholder.

Findley v. Garrett (1952), 109 Cal. App. 2d 166, 240 P. 2d 421 (Hearing denied by Supreme Court);

Denicke v. Anglo-California National Bank of San Francisco (9th Cir., 1944), 141 F. 2d 285, 287, 288.

Hence, on the facts in the present case, plaintiff actually has not even stated a claim upon which relief could be granted, let alone shown jurisdiction in the federal court.

Conclusion.

The appellant herein holds 400 shares or approximately 1.6% of the 24,521 outstanding shares of appellee corporation representing a total investment to him of \$400.00. Although there are numerous other stockholders besides the individual appellees, including two other relatives of the appellant by marriage, no other stockholder has seen fit to join in this costly and unnecessary litigation.

The record may be searched in vain for the slightest evidence of anything indicating a lack of good faith or integrity on the part of the new and independent Board of Directors which went into control over a month prior to the commencement of the within action. The record is equally clear that the Board and the Corporation's counsel cooperated fully with the appellant prior to his bringing the action as well as thereafter, in making available to him the Corporation's records and in examining minutely every claim and charge made by the appellant, despite the fact that although often requested so to do, he failed to supply any evidence to support his charges.

The record also shows clearly that all we have here is a mere difference of opinion between the appellant on the one hand and the new Board of Directors on the other. Such mere difference of opinion, under California law, did not even place the appellant in a position where he could state a claim or cause of action; and even if this Court now were to determine that federal jurisdiction did exist, the action would have to be dismissed for failure to state a claim upon which relief could be granted.

The trial court correctly found that for at least five weeks prior to the commencement of the within action, the Corporation was a completely free agent and not incapacitated from protecting its own interests. Because of such factual situation, the Corporation was properly aligned in its true role as plaintiff, and when so realigned, there is a lack of diversity of citizenship. Hence the action was properly dismissed for lack of federal jurisdiction.

Respectfully submitted,

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No. 14349.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE R. CARR,

Appellant,

vs.

BEVERLY HILLS CORPORATION, a corporation, JOHN P.
LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE,
ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS
J. FERRAR,

Appellees.

On Appeal From the United States District Court for the
Southern District of California, Central Division.

APPELLANT'S REPLY BRIEF.

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FILED

DEC 1 1954

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Appellees.

APPELLANT'S REPLY BRIEF.

I.

Introduction.

It is conceded that the sole question presented by this appeal is whether or not the District Court erred in dismissing the complaint for lack of diversity of citizenship and, therefore, lack of jurisdiction over the subject matter. (Op. Br. 1, 14; Appellees' Br. 4.) Appellant files this reply brief for the purpose of pointing out that a substantial portion of appellees' brief does not deal with the issue of jurisdiction, which is the sole issue before this Court.

II.

Appellees' Argument Concerning a Demand Upon the Corporate Management Is Not Relevant to the Issues Presented by This Appeal.

A. The Rule Relating to a Demand Upon the Corporation's Management, in Secondary Actions by Shareholders, Does Not Deal With the Jurisdiction of the United States Courts.

In an effort to support their position that the District Court lacked jurisdiction over the subject matter, appellees argue strenuously that the appellant did not formally "demand" that the corporation take action to recoup its losses. That argument is not relevant to the issue presented by this appeal for it has long been established that the procedural rule which provides for such a "demand" (Rule 23(b), Federal Rules of Civil Procedure) does not deal with the question of the jurisdiction of the courts, but only prescribes the manner in which the jurisdiction shall be exercised.

The purpose and nature of old Equity Rule 94, in which present Rule 23(b) finds its origins, was discussed at great length by the Supreme Court in *Venner v. Great Northern Railway Company* (1908), 209 U. S. 24, 33-35, 52 L. Ed. 666, 669-670, 28 S. Ct. 328, wherein it had been argued that the rule related to the *jurisdiction* of the United States courts. In disposing of that argument the Supreme Court said, *inter alia*:

"But this argument overlooks the purpose and nature of the rule. The rule simply expresses the principles which this court, after a review of the

authorities, had declared in *Hawes v. Oakland* * * * 104 U. S. 450, 26 L. ed. 827, to be applicable in the decision of a stockholder's suit of the kind now under consideration. *Neither the rule nor the decision from which it was derived deals with the jurisdiction of the courts, but only prescribes the manner in which the jurisdiction shall be exercised.* * * * The jurisdiction * * * is prescribed by laws enacted by Congress in pursuance of the constitution, and this court by its rules has no power to increase or diminish the jurisdiction thus created, though it may regulate its exercise in any manner not inconsistent with the laws of the United States." (Emphasis added.)

That decision has been followed consistently and is cited, quoted, and followed by the United States District Court for the Southern District of California, in a decision by the same District Judge who decided the within case in his decision in *Smith v. Sperling* (S. D. Cal., 1953), 117 Fed. Supp. 781, 802. Appellees have relied heavily upon that case.

The spirit of the above-quoted excerpt from the decision in *Venner v. Great Northern Railway Company* is reflected in Rule 82, Federal Rules of Civil Procedure, which provides:

"These rules shall not be construed to extend or limit the jurisdiction of the United States district courts * * *."

B. The District Court Found That a Demand Upon the Corporate Management Would Have Been Futile.

Apart from the fact that Rule 23(b) does not deal with the jurisdiction of the United States courts, appellees have overlooked, or ignored, the fact that the appellant's verified complaint alleged, and the District Court found [Finding 8, R. 266], that it would have been futile for appellant to make any further demands for relief upon the corporation. [R. 9, 11-16, 266; Op. Br. 14.] The finding was not controverted by the appellee as, indeed, it could not have been.

The futility of a demand is readily apparent when one considers that the fraud and mismanagement charged in the complaint consisted in large part of stripping the corporation of its profit-making facilities and delivering them, piecemeal, to a co-partnership whose members owned 91% of the stock of the corporation [R. 61], and in which the individual defendants were all co-partners, and financially interested. [R. 5.]

Appellees' argument that appellant was required to make a new demand upon the Board of Directors after March 25, 1953, is also invalid. The acts of fraud and mismanagement complained of had taken place many months before, and the controversy between the appellant and the corporation had been going on for more than three (3) months. When the attorneys for the corporation and the individual defendants (they were all represented by the same attorneys at that time) [R. 12, 135, 142; Op. Br. 33; Appellees' Br. 19-20], learned that

appellant was about to file his action [R. 11, 133] they hurriedly advised the individual defendants to select some new directors for the apparent purpose of trying to force appellant to begin his efforts all over again. [R. 11-12, 133-137; Appellees' Br. 7.] If the complaint could have been filed a few weeks earlier appellees' argument would not have existed at all.

The argument has nothing to do with the merits of case and its facts do not change the facts of the controversy between appellant and the corporation. We have seen that the whole principle of "demand" has nothing to do with the jurisdiction of the federal courts. It is, therefore, submitted that appellees' argument has nothing to do with the issue before the Court on this appeal.

Respectfully submitted,

GEORGE E. DANIELSON,

Attorney for Appellant.

THOMAS DODD HEALY,

Of Counsel.

No. 14,349

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE R. CARR,

Appellant.

vs.

BEVERLY HILLS CORPORATION, a corporation, JOHN P.
LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWN,
ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS
J. FERRAR,

Appellees.

PETITION FOR REHEARING AND IN THE
ALTERNATIVE FOR STAY OF MANDATE.

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FILED

JUL 21 1956

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PAUL P. O'BRIEN, CLERK

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No. 14,349

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FOR THE NINTH CIRCUIT

GEORGE R. CARR,

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vs.

BEVERLY HILLS CORPORATION, a corporation, JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWN, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Appellees.

PETITION FOR REHEARING AND IN THE ALTERNATIVE FOR STAY OF MANDATE.

*To the Honorable, the United States Court of Appeals
for the Ninth Circuit and to the Honorable Albert
Lee Stephens, James Alger Fee and Richard H.
Chambers, Judges Thereof:*

Comes now George R. Carr, appellant in the above-entitled cause, and presents this, his Petition for Rehearing of the above-entitled appeal and, in the alternative, for Stay of Mandate for a reasonable time enabling him to file his Petition for Writ of Certiorari in the Supreme Court of the United States.

In support of his Petition for Rehearing appellant respectfully shows:

That the opinion of this Honorable Court in this case is erroneous and contrary to law in the following particulars:

I.

The Court erred in holding that the District Court did not err in finding that at the time of the commencement of the action there was no domination of the defendant corporation resulting in the destruction of its independent volition.

II.

The Court erred in holding that the defendant corporation must be realigned as a plaintiff simply because of a finding that the corporation was not under the domination of the individual defendants or under the control of persons who were antagonistic or hostile to the financial interests of the corporation, and therefore was not incapacitated from protecting its own financial interests.

I.

The Court Erred in Holding That the District Court Did Not Err in Finding That at the Time of the Commencement of the Action There Was No Domination of the Defendant Corporation Resulting in the Destruction of Its Independent Volition.

It is axiomatic that a corporation can exercise its volition only through its board of directors; that the volition of its directors, acting as a board of directors, is the will of the corporation.

Appellant pointed out, in his opening brief (pp. 5-8, 32-33), the extent and manner in which the individual defendants had mismanaged the affairs of the corporation, to their personal gain, at the time of the wrongs complained of, and how they had selected their own successors to endorse their misdeeds (as endorse them they did) only after the plaintiff had, for four long months, insisted and urged that they recognize, respect, and discharge their obligations of trust.

The appellant respectfully submits that the best test, and the only *real* test, of whether there is such a domination of the corporation that its independent volition is destroyed is whether the corporation does, in fact, exercise an independent volition. In other words, the best test of whether a corporation *can* protect its own financial interests is whether or not it *does* protect them.

In the case at bar, the District Court's findings, cited by this Honorable Court, include the statement that it "would have been futile" for the plaintiff to make a formal "demand" upon the corporation.

Appellant respectfully submits that the facts of this case, when put to this realistic test, permit of no conclusion other than that the corporation was, at the time of the commencement of this action, dominated by persons antagonistic of the financial interests of the corporation.

II.

The Court Erred in Holding That the Defendant Corporation Must Be Realigned as a Plaintiff Simply Because of a Finding That the Corporation Was Not Under the Domination of the Individual Defendants or Under the Control of Persons Who Were Antagonistic or Hostile to the Financial Interests of the Corporation, and Therefore Was Not Incapacitated From Protecting Its Own Financial Interests.

In its opinion this Honorable Court cites and follows its opinion in *Smith v. Sperling* (9 Cir., No. 14,334, filed May 21, 1956), and *Smith v. Sperling*, 117 Fed. Supp. 781. The purport of the opinion seems to be that unless the management of corporation is dominated by the wrongdoers themselves, or by persons who are antagonistic to the financial interests of the corporation, then the corporation is not "incapacitated" from protecting its own financial interests and it must be aligned as a plaintiff.

Appellant respectfully submits that this entire formula is premised on error and that it is contrary to the established precedents.

In the first place it appears to assume that a corporation can have a "capacity" to act in all except those cases in which there is substantial identity between its management and the alleged wrongdoers in the acts complained of. The Appellant submits that this is fallacious because the true test should be, "What action is the corporation

taking?" not "What action *could* the corporation take?" The stockholder, in protecting his interests as such, is not to be concerned with what management *can* do, if it is so inclined, he is to be concerned with that which management actually *does* do. This, we submit, is the only realistic, and valid, test.

Secondly, the formula which has been followed in the *Smith v. Sperling* decision requires, as its principal and essential ingredient, a generous amount of "antagonism" and "hostility," between management and the financial interests of the corporation, so much so, in fact, that the corporation is "incapacitated" from protecting its financial interests.

The appellant strongly urges this Court to reconsider this branch of its opinion for the reason that, as appellant understands the authorities, this theory is directly contrary to law and precedent.

It is appellant's position that such "hostility" or "antagonism," in the ordinarily-understood meaning of those words, is not necessary in order to align the corporation as a defendant in this type of case. As the Supreme Court said, in *Delaware & Hudson Co. v. Albany & Susquehanna R.R. Co.* (1909), 213 U. S. 435:

"* * * The attitude of the directors need not be sinister. It may be sincere. * * *"

See also:

Ashwander et al. v. Tennessee Valley Authority, et al. (1935), 297 U. S. 288, 56 S. Ct. 466, 80 L. Ed. 688;

Schmidt v. Esquire, Inc. (1954), 210 F. 2d 908, 911;

Groel v. United Electric Co. (1904), 132 Fed. 252, 263.

Conclusion.

It is respectfully submitted that the decision of this Court is erroneous in the several particulars heretofore set forth, to the detriment and prejudice of the appellant and all others similarly situated, and that appellant is justly entitled to a reconsideration and to a rehearing in order that he may fully and completely present the errors complained of.

Petition for Stay of Mandate.

In the event this Court should deny the above Petition for Rehearing appellant respectfully requests the Court to make its order staying mandate in this cause for a reasonable time in order to enable appellant to file his Petition for Writ of Certiorari in the Supreme Court of the United States.

Respectfully submitted,

GEORGE E. DANIELSON,

Attorney for Appellant.

THOMAS DODD HEALY,

Of Counsel.

Certificate of Counsel.

I, George E. Danielson, counsel for the above-named appellant, do hereby certify that in my judgment the foregoing Petition for Rehearing is well founded, fully justified, and that it is not interposed for delay.

GEORGE E. DANIELSON,
Attorney for Appellant.

THOMAS DODD HEALY,
Of Counsel.

No. 14354

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAMES H. SEWELL, doing business under the fictitious firm
name and style of BURNS CUBOID COMPANY,

Petitioner,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Petitioner's Opening Brief on Petition to Review
Decision and Order of the Federal Trade
Commission.

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No. 14354

IN THE

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FOR THE NINTH CIRCUIT

JAMES H. SEWELL, doing business under the fictitious firm
name and style of BURNS CUBOID COMPANY,

Petitioner,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Petitioner's Opening Brief on Petition to Review
Decision and Order of the Federal Trade
Commission.

I.

STATEMENT OF JURISDICTION.

Under Section 5 of the Federal Trade Commission Act (52 Stat. 111; 15 U. S. C. 45-58), this is a Petition by James H. Sewell for Review of an Order of and proceedings before the Federal Trade Commission, a United States board or commission (Rule 43, Rules, Court of Appeals, Ninth Circuit).

It arises after exhaustion of proceedings by, of, and before that Commission: Decision of the Commission [I R. 170]; Findings as to the Facts (Commission's) [I R. 171-183]; Conclusion (of the Commission) [I R. 183]; and Order (of the Commission) [I R. 183-186].

The proceedings before the Commission were instituted by the Commission (Complaint was issued by the Commission for proceedings before the Commission, on motion of the Commission [I R. 2-8] and referred to a Trial Examiner of the Commission) in February, 1951. At that time, Burns Cuboid Company was a copartnership—and so designated in the Complaint—consisting of James H. Sewell and George Pepperdine [Answer, I R. 14-30]. During the time period of the proceedings, Sewell acquired the entire ownership [I R. 171; II R. 267-268] and hence is the sole petitioner here [R. 187-200; Pet. for Review]. Answer was filed [I R. 13-30] and hearings were held in Washington, D. C., New York, Los Angeles and Chicago.

II.

STATUTES BELIEVED TO SUSTAIN JURISDICTION.

Federal Trade Commission Act, 52 Stat. 111, 15 U. S. C., Secs. 45-58; Review of Federal Trade Commission Order, 15 U. S. C., Secs. 45(c), 45(d), 45(e).

III.

PLEADINGS CITED TO SHOW EXISTENCE OF JURISDICTION.

Complaint [I R. 2-8] (jurisdiction of Commission).

Answer [I R. 13-30].

Petition for Review [I R. 187-200] (jurisdiction of this Court).

IV.

FACTS BELIEVED TO SHOW EXISTENCE OF JURISDICTION.

Petitioner (and predecessor partnership, in Santa Ana, Orange County, Southern District of California) is engaged in manufacturing, offering for sale and selling a device, as "device" is defined in the Federal Trade Commission Act, and has caused these devices to be transported from the place of business to purchasers thereof located in various other States, and since 1947 has disseminated, and is now disseminating advertisements containing representations and statements concerning the device by United States mail and other means, in interstate commerce [Stipulation as to Facts, I R. 5-9; Findings of Commission, I R. 171(a)-174].

V.

SUMMARY OF FACTS.

The gist is alleged false advertising of a device sold in interstate commerce.

The device is a shoe insert, NOT AN ARCH SUPPORT. It is made chiefly of leather and cork, the feature being that while its original top surface is flat, its thickness varies at various points, so that corrugations in the nature of peripheral wedges and pad inserts are built in and are so modified by the pressure of the wearer's foot as to adapt the device to fit the wearer's sole [Com. Ex. 3, II R. 10; Pet. Ex. 1, II R. 100; Pet. Exs. 25 and 26].

The advertising claims and statements are detailed in the Complaint [I R. 4-5]. These are repeated and *numbered* in the Answer [I R. 16-20].

Two types of defenses are interposed: As to one set of advertising claims, truth is the defense. As to a second set of advertising claims, non-user since 1947 was the defense.

As to the second category the proceedings were dismissed [I R. 182, 186], since the Commission found that petitioner Sewell had discontinued such use in 1947, more than three years before the Complaint was filed. Mr. Sewell testified this was to cooperate with the Federal Trade Commission [II R. 654]. The advertising statements voluntarily abandoned by petitioner on request of the Commission were (numbered as in the Answer):

(2) Cuboids strengthen weak muscles and counteract poor circulation [I R. 17].

(4) Cuboids aid circulation [I R. 17].

(6) Cuboids strengthen weak feet [I R. 17].

(10) Cuboids stimulate flow of nervous energy in the feet [I R. 18].

The advertising statements defended by Sewell as true are (numbered as in the Answer):

(1) Cuboids help to *balance your* body weight [I R. 16].

(3) Cuboid *Foot Balancers* [I R. 17].

(5) Cuboids . . . *relieve strain and fatigue* [I R. 17].

(7) . . . *the foot and body balance* . . . Cuboids afford [I R. 17].

(8) . . . *the relief from aches and pains* Cuboids afford [I R. 17].

(9) Better poise *and balance* replace aches and pains [I R. 17].

(11) Drive away *foot fatigue* with Cuboids [I R. 18].

(12) Enjoy more normal foot action with Cuboids [I R. 18].

(13) They're the modern way *to foot relief*—combining scientific principles of *balance and support* to *lessen fatigue* and help improve your stance [I R. 18].

(14) Now everyone can enjoy better posture, poise and *balance with* Cuboids [I R. 18].

(15) Metal-Free Cuboids [I R. 18].

(16) Especially designed to help you enjoy increased foot health and comfort [I R. 18].

(17) With Cuboids foot pains often disappear as if by magic [I R. 18].

(18) Cuboid *foot balancers* make housework less tiring [I R. 19].

(19) Cuboids help *to distribute body* weight [I R. 19].

(21) The feet are the body's foundation [I R. 19].

(22) Cuboids *balance* this foundation and provide the basis for correct posture [I. R. 19].

(23) The Cuboid bone is the keystone of the outer or weight-bearing arch and its position determines the relative position of every other bone in the foot [I R. 19].

(24) Cuboid metal-free foot *balancers* are scientifically designed to help bring these bones into normal position [I R. 19].

(25) Cuboids afford effective *relief to aching feet* [I. R. 19].

(26) Cuboids afford effective relief to calloused feet [I R. 19]. (Emphasis added to clarify.)

Wherever the claim is that the device will afford relief to *strained, tired feet*, the Commission (by a negative finding) [I R. 182-183] has admitted the truth of the claims, and has dismissed its charges as to these.

The remaining categories of advertising here involved then are:

(1) Claims as to:

(a) Body balance (including poise, stance and posture);

(b) Foot balance.

(2) Claims as to relief:

(a) from aches and pains;

(b) From callouses.

(3) Claims as to more normal foot action, increased foot health, foot comfort, etc.

These the Commission has held to be all categorically false.

VI.

QUESTIONS INVOLVED.

(1) Was Petitioner accorded a fair trial before the Commission and before the Commission's own Trial Examiner?

(2) Are the Findings of the Commission consistent with its own decision and order?

(3) Was the Trial Examiner biased?

(4) Is there substantial, or any, *evidence* to support the Commission's Findings?

(5) Was it fair (or prejudicial error) to refuse to reopen this Petitioner's defense to hear the offered testimony of Dr. Glassman?

(6) Did the Trial Examiner (and the Commission) give a correct evaluation of the testimony of Doctors Hiss and Garner, *i.e.*, when coupled with the testimony of the Commission's experts, is there *any substantial conflict*?

(7) Purported impeachment of defense witnesses, which, if at all, was impeachment upon immaterial matters, was permitted. This swayed, erroneously, the decision of the Trial Examiner and the Commission.

(8) The entire process, *i.e.*,

(a) The issuance of the Complaint *by the Commission* (which influenced and biased the Trial Examiner);

(b) The bias of the Trial Examiner as reflected in his rulings, decisions, orders and findings (*which influenced the Commission*); and

(c) The prosecution of the entire proceedings before the *Commission's* Trial Examiner, and the *Commission* itself, by the *Commission's* attorney, on the Complaint issued by the *Commission*

all constituted a re-merger of the tribunal powers of the Federal Government at an administrative level in such manner as here to prevent the Petitioner from having been accorded a fair trial and due process.

(9) What is the meaning of "Balance"?

(10) How can the findings as to "balance" be understood?

VII.
SPECIFICATIONS OF ERROR.

A. Of the Trial Examiner.

The Trial Examiner erred:

(1) In refusing to admit [I R. 84] the United States Patent, offered as Sewell's Exhibit 18 for identification, Patent No. 2,287,341 [II R. 282-284].

(2) Upon the offer in evidence (and refusal) of Sewell's Exhibit 19 [II R. 290-295] for identification, in stating that a witness would have to be called to prove the facts which were implicit in the offered evidence; and when an offer of such oral proof by Dr. Glassman, a witness, was made [I R. 78; IV R. 871-880], in refusing to receive such proof and in refusing to reopen Sewell's defense for such purpose [I R. 86; IV R. 871-880] and in holding such offer to be "cumulative."

(3) In refusing to grant Sewell's Motions to Strike from the Record [I R. 34-49, Specifications 1-58 incl.].

(4) In refusing to admit in evidence Sewell's Offer of Proof *re* Exhibits 19-A to 19-Z-259 inclusive [II R. 287-295; I R. 58-70].

(5) In refusing to admit in evidence Petitioner's offered Exhibits 20-A to 20-Z-72 [I R. 72-76; II R. 296-300].

(6) In refusing to permit a letter into evidence or into the Record when a witness had been questioned about it [III R. 357-360]. (Letter *re* pressure on inside arch.)

(7) By overruling Petitioner's objections [III R. 363 *et seq.*, 367].

(8) In gratuitously striking an answer by the witness [III R. 376]. And in summarily, rudely and unnecessarily admonishing an intelligent, courteous witness [III R. 377].

(9) By engaging in an argumentative, arbitrary attitude toward the witness [III R. 382, 393, 395, 406, 420, 424-425, 435].

(10) In refusing to permit the witness to answer [III R. 444-445].

(11) By rejecting Petitioner's offered Exhibit 21 [III R. 505]. (Elftman's work.)

(12) By questioning Dr. Garner's qualifications [III R. 568].

(13) In ruling adversely to Petitioner's clear and sound objection [IV R. 676, 682-684].

(14) By taking, obviously, the side of the Commission's attorney in badgering a witness [IV R. 688-690].

(15) By gratuitously admonishing the witness during cross-examination [IV R. 749-750].

(16) By attempting to keep actualities out of the Record [IV R. 790].

(17) By refusing proper rebuttal questions after immaterial cross-examination [IV R. 799].

(18) By erroneously and ignorantly admonishing counsel concerning leading questions [IV R. 800].

(19) By refusing legitimate rebuttal testimony [IV R. 805].

(20) In failing to apply the same rules of evidence (as to leading questions) to the Commission as to the defense [IV R. 825].

(21) In permitting duplicitous questions [IV R. 833].

(22) In virtually preventing a substantial part of the cross-examination by Petitioner of the Commission's witness Dr. Lewin [IV R. 889-890].

(23) By refusing to permit proper cross-examination [IV R. 904-905].

B. Of the Commission.

The Federal Trade Commission erred:

(1) In finding the device has therapeutic value (by the inverse means of finding that the “greater weight of the evidence adduced in this proceeding does not support a conclusion that respondent’s device possesses no value as an aid to strained, tired feet . . .” [I R. 182, 183]) and in simultaneously finding that the “device is not an effective treatment for ordinary foot aches and pains and has no therapeutic value in the treatment of aching or painful feet” [I R. 180], and in inconsistently simultaneously ordering [I R. 184] Sewell to cease and desist from advertising that wearing the device “will result in more normal foot action or improved foot action or health.”

(2) In making inconsistent findings:

(a) [I R. 178] that in the device “the circumstance that both sides of the device are raised and there is the tendency for these lateral elevations to *balance one another out*” (Italics ours) and, simultaneously,

(b) [I R. 180] that “the use of Cuboids will not assist the wearer to attain *body balance* or *foot balance*, or assist beneficially in the distribution of body weight,” and in ordering Sewell to cease and desist from advertising [I R. 184]:

(a) “That the wearing of respondent’s device will assist in balancing the feet or body.”

(3) In accepting at face value the Commission’s Attorneys’ and the Trial Examiner’s appraisal of Sewell’s experts’ testimony rather than analyzing it to find its inherent truth, thereby preventing a fair trial.

(4) In failing to see that the Commission's witness Dr. Lewin actually might easily have been the inventor of the device in question.

(5) In failing to give credence to the experiential, pragmatic testimony of lay witnesses.

(6) In failing to accord Petitioner a fair trial.

(7) In failing to base findings upon substantial evidence.

VIII.

ARGUMENT OF THE CASE.

A. Evidentiary Rulings.

These are brought to the Court's attention in Specifications of Error of the Trial Examiner, numbered (*supra*) (1), (2), (3), (4), (5), (6), (7), (8), (9), (10), (11), (13), (14), (18), (19), (20), (21), (22), (23), (24) and (25).

Our specifications above cite the Court to the Record. We hereafter treat them under categories by subject matter rather than by specification numbers.

(i) The Patent.

The Petitioner offered in evidence a United States Letters Patent [Ex. 18 for Iden.; I R. 84; II R. 282-284; Pat. No. 2,287,341].

The patent is that under which the device is manufactured, sold and used. Reference is made to the context of the claims thereof for the purpose as indicated. On page 283 [Vol. II of the Record], the Record shows that it was urged that the patent itself contains a statement, and its claims contain language almost identical with the advertising which is sought to be held false by

the Commission. The United States Government issued the patent and thereby sanctioned the utilization of the language which is contained within the patent. It is the contention of the Petitioner herein that there is only one United States Government, and that the Trial Examiner erred in not admitting said patent into evidence.

(ii) The Doctors' Prescriptions.

In addition to the patent, the Petitioner, before the Trial Examiner, made certain Offers of Proof. The first of these was with reference to Exhibits numbered 19 to and including 19-Z-259, all for identification, as set forth in I R. 58 to 70. These consisted of doctors' prescriptions to patients for use of the device in question, received by retail outlets of the Petitioner in the regular course of his business, upon the basis of which a pair of Cuboids was in each instance sold to a customer.

At II R. 290-295, the offer was made of these documents; at I R. 71-76 a written Offer of Proof concerning these documents was made. They consist of what are apparently prescriptions of doctors, *i.e.*, members of the medical profession, from many varied parts of the country. The testimony on which they were based and upon which admission was sought was that of Mr. Sewell, the Petitioner herein [II R. 285-296]. The evidence was, of course, in one sense hearsay. *It was not offered, however, to prove the truth of any statement therein made.* The documents were identified by Mr. Sewell, the Petitioner here, then on the witness stand and according to his testimony, each and all were received by the Burns Cuboid Company from representatives in the field, and have been received and kept by Mr. Sewell in the regular course of his business, and were presented to sales rep-

representatives by people who came into get Cuboids. These were, we submit, admissible under either of two well established rules:

(1) Under the Federal Ordinary Business Records Statute, and (2) under the universal exception to the hearsay rule that hearsay is always admissible when offered to prove *what was said* and not the truth of the saying.

(1) Title 28, United States Code, Section 695, is known as the Federal Ordinary Business Records Statute. It provides as follows:

“695. Admissibility; definition of ‘business.’—In any court of the United States and in any court established by Act of Congress, any writing or record, whether in the form of an entry in a book or otherwise, made as a memorandum or record of any act, transaction, occurrence, or event, shall be admissible as evidence of said act, transaction, occurrence, or event, if it shall appear that it was made in the regular course of such business to make such memorandum or record at the time of such act, transaction, occurrence, or event or within a reasonable time thereafter. All other circumstances of the making of such writing or record, including lack of personal knowledge by the entrant or maker, may be shown to affect its weight, but they shall not affect its admissibility. The term ‘business’ shall include business, profession, occupation, and calling of every kind.”

This has been construed in the case of *Palmer v. Hoffman*, 318 U. S. 109, 87 L. Ed. 645, 63 S. Ct. 477, affirming 129 F. 2d 976, and it is there held that this section should be liberally interpreted so as to do away with anachronistic rules which gave rise to its needs and at which it was aimed; “regular course” of business

must find its meaning in the inherent nature of the business in question and in the methods systematically employed for the conduct of the business as a business.

In *Park v. Metropolitan Life Insurance Company*, 138 F. 2d 123, a New Jersey birth certificate of a child was held admissible to prove the age of the parents recited therein as against the contention that it should be limited to the proof of the birth of the child.

Likewise, in the same case, hospital records reciting the insured's age were held admissible in evidence to prove his age where they were made when the insured went to the hospital for diagnostic purposes.

The offer in this case was made to refute the testimony elicited by the attorney in support of the Complaint that the medical profession all over the United States would have nothing to do with the product.

It did not purport to prove anything else, or anything but that these prescriptions had been received by the respondents in the regular course of its business and each one kept as part of the memorial of a transaction. The fact of their having been received by the petitioner, and not any fact contained, was the fact sought to be proved.

(2) The second theory is found in *Jones on Evidence in Civil Cases* (3d Ed.), Section 300, where we find the following statement of this rule (pp. 455-456):

“ ‘It does not follow because the writing or words in question are those of a third person, not under oath, that therefore they are to be considered as hearsay. On the contrary, it happens in many cases that the very fact in controversy is whether such things were written or spoken, and not whether they were true.’ ”

The Hearing Examiner should have admitted these in evidence, we submit, inasmuch as they show that at least 275 prescriptions have been received by the Petitioner in the course of its business from doctors in many, many parts of the United States. Judging their weight of course would be another matter.

Therefore, we submit emphatically that the Trial Examiner erred prejudicially in not admitting these documents, and thereby deprived Petitioner of a fair trial.

(iii) The Testimonials.

At page 296, *et seq.*, the Record reveals that another Offer of Proof was made of a number of lay testimonials [98 sheets numbered Exs. 20-A to 20-Z-72, respectively].

By the same line of reasoning and by the argument as above, these also should have been admitted by the Hearing Examiner, and the fact sought to be proved there is the fact that the unsolicited testimonials form a large background for the advertising which is used.

The Court should, we believe, consider that the Commission is not bound to follow the strict rules of evidence which prevail in courts of law.

Stanley Laboratories v. Federal Trade Commission (9 Cir.), 138 F. 2d 388;

Phelps-Dodge Refining Corp. v. Federal Trade Commission, 139 F. 2d 393.

The hearsay rule was instituted originally in order to protect juries from imposition. In a celebrated case, Lord Mansfield called attention to the fact that:

“In Scotland and most of the Continental states, the judges determine upon the facts in dispute as well as upon the law and they think there is no

danger in their listening to evidence of hearsay because, when they come to consider their judgment on the merits of the case, they can trust themselves entirely to disregard the hearsay evidence, or to give it any little weight which it may seem to deserve. But in England, where the jury are the sole judges of fact, hearsay evidence is properly excluded, because no man can tell what effect it might have upon their minds.”

Berkeley Peerage Case, 4 Campb. 401, 11 Eng. Rul. Cas. 310.

Since hearings before the Federal Trade Commission and its very own Trial Examiners are not before a jury, and since the rule of relaxation is the announced rule for the Federal Trade Commission, we again submit that the Trial Examiner (and the Commission) erred prejudicially. We do not believe that either the Trial Examiner or the Federal Trade Commission is at liberty to disregard that which is extremely plain from the evidence. Nor do we believe that either Federal Trade Commission or the Trial Examiner is entitled to exclude proffered evidence and then make findings contrary to the evidence ruled out, when there is no contrary evidence.

(iv) The Dr. Glassman Offer.

Consistent with his unfair attitude, the Trial Examiner, in refusing admittance to Petitioner's Exhibits 19 through 19-Z-259, remarked and ruled [II R. 288]:

“Trial Examiner Haycraft: You would have to prove the truth of those documents in order to prove what they are attempting to prove.”

And at II R. 294-295 appears the following:

“Trial Examiner Haycraft: . . . What you are trying to prove is to disprove opinion testimony of

a doctor that no reputable doctor, we'll say, would prescribe Cuboids. Now, if there is going to be any relevancy at all, it must be that some reputable doctor did prescribe it. If that is the purpose of the offer, then counsel for the complaint is entitled to cross-examine the doctor who prescribed Cuboids, and whether he is a man of reputation, and also that the facts were and the surrounding circumstances under which the prescription was granted.

Now, in the absence of that, then the document hasn't any probative value. If the offer is going to be made—we have discussed this before the offer was formally made—if you are about to make a formal offer of respondents' documents 19-A—

Mr. Bellinger: I think he did offer them.

Trial Examiner Haycraft: If that is true, then I am rejecting the offer on the ground it hasn't any probative value in this proceeding."

Taking this in conjunction with Petitioner's Offer of Proof as to the testimony of Dr. Glassman [I R. 78-82 *et seq.*, as ruled upon by the Examiner at [IV R. 875], we find:

"It is the opinion of the Hearing Examiner that the subject matter of the offer is cumulative and is substantially covered in the testimony of the previous witnesses,"

and in ruling [IV R. 876] that the Petitioner was not permitted to reopen the case.

We respectfully ask the Court to consider this in conjunction with the discussions concerning rebuttal by the Commission [IV R. 812-816] with reference to the attitude of the Trial Examiner concerning the reopening in effect by the Commission.

(v) Refusal to Strike From the Record.

At I R. 33-49 is contained a Motion to Strike, with fifty-eight specifications. These pertain to various categorical statements made by the expert witnesses for the Commission.

It arises from a colloquy and a ruling by the Trial Examiner found at II R. 250, lines 18, *et seq.* There it appears that Petitioner's attorney was asking a witness on the stand a question as to his opinion (he was an expert), and the following occurred:

"Q. In your opinion, then, Doctor, is the form of the balance correctly and truthfully applicable to the—

Trial Examiner Haycraft: No, we are not going to let the doctor decide that or any doctor, as far as that is concerned. It is a problem for the Commission to decide, after it takes into consideration the testimony, the factual testimony and the opinion testimony of the doctors, whether they result from hypothetical questions or whether it has been related to facts, just as he asked the other question that you just asked, and the witness was properly allowed to answer.

After the Commission has taken the words and compared the testimony they will have to come to a conclusion as to whether the language used in the form is proper. That is not a question that can be answered by one man.

Mr. Maury: I am just asking him, your Honor, for his opinion as to that.

Trial Examiner Haycraft: Well, objection sustained as to that."

Since the attorney for the Commission, throughout the entire course of his interrogation of witnesses produced

by the Commission, had asked altogether similar opinion questions of the experts produced by the Commission, the position of the Petitioner was and is that the same rule should apply with reference to the introduction of evidence by those experts brought forward by the Commission as to the experts brought forward by the Petitioner. The Trial Examiner broke in upon the attorney for the petitioner and categorically denied admittance to the opinion of the witness, as to the properties of the device. Thereafter, when a Motion to Strike was made as to similar questions and answers given by the Commission's witnesses, the Motion to Strike was denied.

B. The Administrative System of the Federal Trade Commission, the Attitude of the Trial Examiner, and the Evidentiary Rulings, Altogether, Denied a Fair Trial.

The attitude of the Trial Examiner toward the Commission's case, as compared with his attitude toward Petitioner's case, was that of a crusader, not a jurist. The Trial Examiner refused to permit into evidence a letter on request of Petitioner when the witness *had* been questioned about it by the Commission [III R. 357-360].

The Trial Examiner twisted the issues by permitting evidence concerning systemic diseases [III R. 363]—entirely outside the issues.

The Trial Examiner gratuitously struck a cogent, enlightening opinion by a qualified expert [III R. 376], and rudely admonished the witness [III R. 377], thereby adding to the badgering of the witness going on by the attorney for the Commission [III R. 377].

The Trial Examiner engaged in an argumentative, arbitrary, sarcastic, angry, unjudicial attitude toward the

witness, which is readily discernible, even in the cold Record [III R. 382, 393, 395, 406, 420, 424, 425, 435].

Even casual scrutiny reveals that the school of thought envisioned and embraced by Dr. Hiss was one that the Trial Examiner would not listen to, did not want to listen to, had not wanted to listen to, and mentally rejected whenever it started to come into the Record.

The Trial Examiner refused to permit the witness to answer [III R. 444-445]; the Trial Examiner required extraordinary evidence of a qualification of Dr. Garner [III R. 568]; the Trial Examiner leaned over backwards to admit evidence on behalf of the Commission [IV R. 682]; the Trial Examiner took the side of the Commission's attorney in threatening to discommode a witness in his anxiety to make a train [IV R. 688-690]; the Trial Examiner exhibited bias by gratuitously limiting a witness' answer to "yes" or "no" when the witness had given a perfectly sensible and clear answer, this during cross-examination [IV R. 749-750]; the Trial Examiner attempted to keep actualities out of the Record [IV R. 790].

The Dr. Dodds (not a witness) there mentioned sat through the entire series of hearings in Los Angeles and coached the attorney for the Commission; and when the attorney for the Petitioner stated, "Mr. Maury: May the record show that Dr. Dodds nodded his head affirmatively?" the Trial Examiner stated: "No, the record doesn't have to show that." The Trial Examiner attempted to keep this actuality out of the Record when, in fact, the actuality occurred in his presence, and there was no tacit or express ruling or understanding that such should be kept out of the Record.

At IV R. 799, the Trial Examiner simply refused proper rebuttal questions after cross-examination. The

Trial Examiner improperly and ignorantly admonished counsel concerning leading questions [IV R. 800], and refused proper rebuttal testimony [IV R. 805-806]. The Trial Examiner admitted leading questions by the Commission [IV R. 825], while virtually, in the same breath, admonishing the attorney for the Petitioner [IV R. 800] against leading questions—thus applying one rule to the Commission's elicitation of evidence and another to the Petitioner's. The Trial Examiner permitted the attorney for the Commission to ask duplicitous questions over the objection of Petitioner [IV R. 833]. The Trial Examiner virtually prevented cross-examination by Petitioner of the Commission's own witness [IV R. 889-890], and in stating that Petitioner's counsel had asked "an absurd question."

The entire process is one which prevents fair trials, and its pragmatic working is most aptly demonstrated here. The re-merger at "a lower level" of the tri-unal powers of the Federal Government has been the subject of many criticisms of the administrative process. In this case it engendered a "bootstraps" device by which the Federal Trade Commission has lifted itself with a rope of words to a point where it now austere finds that the representations of the Petitioner's advertisements are untrue.

Woodrow Wilson, then President, in 1913 conceived the idea of a trade commission to implement certain legislation then being considered by Congress. His purpose was to meet businessmen half way. He intended this Commission to be an agency which would *help* businessmen understand the antitrust laws and the conduct required to comply with those laws. On January 20, 1914, he sent a message to Congress in which he asked it to

create an "interstate" trade commission. President Wilson's message to Congress shows the type of agency he had in mind:

"The business of the country awaits, has long awaited and has suffered because it could not obtain, further and more explicit *legislative* definition of the policy and meaning of the existing antitrust law. . . . Surely we are sufficiently familiar with the actual processes and methods of monopoly and of the many hurtful restraints of trade to make definition possible, at any rate up to the limits of what experience has disclosed. These practices, being now abundantly disclosed, can be explicitly and item by item forbidden *by statute* in such terms as will practically eliminate uncertainty, the law itself and the penalty being made equally plain.

"And the businessmen of the country desire something more than that the menace of legal process in these matters be made explicit and intelligible. They desire the advice; the definite *guidance and information* which can be supplied by an administrative body, an interstate trade commission.

"The opinion of the country would instantly approve of such a commission. *It would not wish to see it* empowered to make terms with monopoly or in any sort to *assume control of business*, as if the Government made itself responsible. It demands such a commission *only as an indispensable instrument of information and publicity*, as a clearing house for the facts by which both the public mind and the managers of great business undertakings should be guided . . .

"Inasmuch as our object and the spirit of our action in these matters is to meet business half way in its processes of self-correction and *disturb its legitimate course as little as possible*, we ought to

see to it, and the judgment of practical and sagacious men of affairs everywhere would applaud us if we did see to it, that penalties and punishments should fall not upon business itself, to its confusion and interruption, but upon the individuals who use the instrumentalities of business to do things which public policy and sound business practice condemn.” (51 Cong. Rec. 1962-1963 (1914).) (Emphasis added.)

Acting upon that recommendation in the Fall of 1914, the Congress passed the Federal Trade Commission Act. At the same time it passed the Clayton Act, which contained the results of its own study. (The Federal Trade Commission Act was approved September 26, 1914 [38 Stat. 717]; and the Clayton Act was approved October 15, 1914 [38 Stat. 730].)

President Wilson wanted a legislative definition of the policy of the statutory law and an administrative agency “only as an indispensable instrument of information and publicity.” Rejecting administrative control of business, he wanted the Congress to define the laws. The Commission’s function was to be only to publicize, and inform businessmen of, the requirements of those laws. He intended to “disturb the legitimate course [of business] as little as possible.” The Commission, however, over the years has become a Court, specialized as is the Tax Court, not an agency such as President Wilson conceived.

In 1950, more than thirty-five years after President Wilson’s message outlined the Commission’s function, a report of the Senate Interstate and Foreign Commerce Committees found that:

The Commission does not consider itself a body such as that envisioned by President Wilson. In the

hearings before this subcommittee, the Commsision has taken the position that it cannot indicate, in advance of specific litigation before it, the rules of law applicable to business in interstate commerce. (Sen. Rep. No. 2627, 81st Cong. 2d Sess. 5 (1950).)

After an exhaustive study of the Commission, the Hoover Commission in 1949 made comprehensive findings of its performance record. Reviewing the purpose intended in the creation of the Federal Trade Commission, the Hoover group said that "over the years, the Commission has engaged mainly in activities contributing little toward accomplishing the primary Congressional objective of assuring widespread effective competition." (Hoover, Task Force Report on Regulatory Commissions 122 (1949).)

The Hoover group restated the obligation imposed on the Commission by the Congress with the conclusion that "the Commission also has responsibilities for furtherance of the policy and mandate of the statutes. In a field of such public interest, the Commission has a duty to be truly informative, concerning its own standards and policies." (Hoover, Task Force Report on Regulatory Commissions 131 (1949).)

The Commission's advice to businessmen is that they can learn the business conduct required of them by the statutes only when the Commission chooses to sue them and to litigate the propriety of their business activities in an adversary proceeding. As a result, no one knows what is now the law in this field. The Commission has refused to assist businessmen to understand the law.

Freight absorption has been the subject of inquiry of a special Senate subcommittee in 1950 which inquired into

the extent to which the Commission qualified the law on that subject. The Senate committee found that "much of this confusion—conceded by everyone to exist—is directly attributable to the Federal Trade Commission." (Sen. Rep. No. 2627, 81st Cong., 2d Sess. 11 (1950).)

The Senate then asked the Commission for a formal expression of when freight absorption is lawful under existing statutes.

The Commission advised the business world in November, 1950, that freight absorption is lawful whenever it isn't unlawful. "The legality of freight absorption which has no unlawful purpose or effect is clear today. Such freight absorption has not been attacked by the Commission in any proceeding, and the Commission has repeatedly made public announcement that such freight absorption is legal." (Letter reprinted in Sen. Rep. No. 2627, 81st Cong., 2d Sess. 22 (1950).)

The Committee made the following closing comment:

"We are somewhat surprised at being told by an agency that the legality of anything which has 'no unlawful purpose or effect' is clear. Obviously, anything that is not illegal must be legal. The Commission could equally properly have said that killing a person is not unlawful if it 'has no unlawful purpose or effect.'" (Sen. Rep. No. 2627, 81st Cong., 2d Sess. 9 (1950).)

We do not wish unduly to belabor the Court with a discussion of the Federal Trade Commission. In the instant case, the Complaint was made by the Commission (for filing and hearing before the Commission) upon the sole ground that the Commission "had reason to believe" [I R. 2] that Petitioner [predecessors] was violating the law. The bootstraps device is apparent from there

on: The Petitioner here was granted no right to have his side of the story examined before the Complaint was issued against him. True (and not appearing in the Record) there were negotiations toward a stipulation, but those did not bear fruition.

Hearings were then held before one of the Commission's very own Trial Examiners. The attorney who appeared to support the Commission's Complaint was on the Commission's staff. The evidence was voluminous. The Examiner (*a servant of the Commission and previously a prosecutor before it*) was necessarily influenced by the fact that the Commission "had reason to believe" that there was a violation of law.

The Hoover Commission found, among other things, that the Commission's "dockets were preoccupied with false and misleading advertising cases." (Hoover, Op. cited *supra* under 8, at p. 122.)

It is quite probable that the Commissioners cannot, under the circumstances of the work required of them, examine the lengthy record in each case to reach independent conclusions as to the facts.

In the instant case, only three Commissioners sat to hear the argument before the Commission [I R. 186], and obviously only these three could have made the decision, so there, in itself, the Petitioner was deprived of the consideration of two of the Commissioners.

The Honorable James M. Landis, once clerk to Justice Brandeis and later a member of the Federal Trade Commission itself, and later a member of the Securities and Exchange Commission, and for a decade Dean of the Harvard Law School, recently wrote:

"I share completely these criticisms of administrative regulation, but two other points should be made.

The first is a noticeable decline in the quality of the personnel of the top level of bureaucracy that has the responsibility for this administrative regulation. This fact was commented on again and again in the reports of the Hoover Commission. Whether that is something innate to the processes of government or not, I do not know. But the fact is too patent to be denied. Secondly reference must be made to what I would call the utter bankruptcy of the Federal Trade Commission. As a practical matter the deterioration of that Commission has gone beyond the possibility of redemption. If duties of this kind are to be thrust on some agency, there is really only one thing to do, and that is to wipe out the FTC completely and start afresh." (Landis, Monopoly and Free Enterprise 548 (1951).)

On January 24, 1951, speaking to the New York State Bar Association, then Federal Trade Commissioner Lowell B. Mason said:

"Clyde Reed, the late distinguished Chairman of the Subcommittee on Independent Office Appropriations, once characterized the Commission as having dried up and blown away, an entirely unfair and inaccurate description of us, because as a matter of fact, we have not blown away."

The Supreme Court, however, is said to consider the Federal Trade Commission to be "a body of experts." In *Federal Trade Commission v. R. F. Keppel & Bro.*, 291 U. S. 304 (1934), the Court quoted from the 1914 Congressional Committee Reports that the Commission was to be "a body specially competent to deal with [unfair competitive practices] by reason of information, experience and careful study of business and economic conditions," and that it was organized to "give to [the Com-

mission] an opportunity to acquire the expertness in dealing with these special questions concerning industry that comes from experience" (p. 314).

Some fourteen years later, in the so-called *Conduit* case (*Triangle Conduit & Cable Co. v. F. T. C.*, 168 F. 2d 175, 180 (7 Cir., 1948)), the Court of Appeals said that "Congress has left to the Commission the determination of the facts . . . and the weight to be attributed to the facts proved and the inferences to be drawn from them."

In the case of *Federal Trade Commission v. Cement Institute*, 333 U. S. 683, the Court referred to the Commission's long and close examination of the questions in issue and its specialized knowledge which Congress wanted its agency to have and the Court talked about these "men trained to combat monopolistic practices" (p. 726), and said (p. 720):

"We are persuaded that the Commission's long and close examination of the questions it here decided has provided it with precisely the experience that fits it for performance of its statutory duty. The kind of specialized knowledge Congress wanted its agency to have was an expertness that would fit it to stop at the threshold every unfair trade practice—that kind of practice, which is left alone, 'destroys competition and establishes monopoly.'"

Contrary to the opinion of the Supreme Court, Mr. James M. Landis, while Dean of Harvard and four years after leaving the Commission, wrote:

"To assume that any five, ten, or twenty men have the ability to acquire, within their brief official lifetime, the expertness to comprehend the full range of our industrial problems, from aluminum to

zinc, is once more to put our trust in supermen. In the business of governing a nation—to paraphrase Gerard Henderson again—we must take into account the fact that government will be operated by men of average talent and average ability and we must therefore devise our administrative processes with that in mind.” (Landis, *Administrative Process* 87 (1938).)

The Hoover Commission found that the Federal Trade Commission had been hampered by mediocre appointments and that its operations, programs, and administrative methods have often been inadequate and its procedures cumbersome, and that it has largely become absorbed in petty matters rather than basic problems. The Hoover group also reported as to the Federal Trade Commission that “with notable exceptions, appointments to the Federal Trade Commission have been made with too little interests in the skills and experience pertinent to the problems of a competition and monopoly, and too much attention to service to political party.” (Hoover, *Op. Cit. supra*, p. 125.)

Such was the situation here that despite evidence of their *own experts* on cross-examination, which tended to prove that the advertising was true, the Trial Examiner and the Commission both chose to base their decisions upon the categorical one word opinion answers of their experts’ testimony in chief.

These mere parrot-like categorical opinions of the three Arlington doctors must fall before the analytical detailed statements given by them on cross-examination.

“The testimony given by a witness on cross-examination is the evidence of the party in whose behalf he is called and the cross-examiner has the right to

bind his adversary with the truth elicited from his own witness. (Wilson v. Wagar, 26 Mich. 457; Campau v. Dewey, 9 Mich. 417; Chandler v. Allison; 10 Mich. 460; N. Y. Mine v. Negaunee Bank, 39 Mich. 644).”

Heard v. United States (8 Cir.), 255 Fed. 829, 832.

An expert witness’ testimony, even though uncontradicted, must be evaluated as a whole, *including qualifying statements and admissions on cross-examination.*

Koshland’s Estate v. C. I. R. (9 Cir.), 177 F. 2d 851.

“While the jurors are the sole judges of the facts, the question as to whether or not there is substantial evidence in support of the plaintiff’s case is always a question of law for the Court (Grant v. Chicago, etc. Ry. Co., 78 Mont. 97, 252 Pac. 382), and in determining this question, the *credulity of courts is not to be deemed commensurate with the facility and vehemence with which a witness swears.* It is a wild conceit that any court of justice is bound by mere swearing. It is *swearing creditably* that is to conclude judgment . . .” (Emphasis added.)

Morton v. Mooney, 97 Mont. 1, 33 P. 2d 262;

Herbert v. Lankershim, 9 Cal. 2d 409, 472, 71 P. 2d 220.

While the Arlington doctors all gave negative, parrot-like opinions on their testimony in chief, on cross-examination they all expressly admitted the truth of Petitioner’s advertising claim.

We believe the following excerpts from the Arlington doctors’ respective cross-examinations show beyond peradventure that our controversial advertising claims are all

true, and the Trial Examiner [and the Commission] both disregarded the rule that the burden of proof was on the Commission.

Thus under the foregoing authorities, and under the following testimony (of the Commission's own doctors), there was not only a failure of proof as to falsity, *i. e.*, no substantial evidence to support the findings, either of the Commission or of the Trial Examiner, but positive proof of the truth of our claims:

C. The Evidence of Commission's Experts on Their Case in Chief Proved the Truth of the Advertising Claims, During the Case in Chief.

DR. ENGH (for the Commission) [II R. 39-40]:

"Q. Now, Doctor, you made the statement several times throughout the course of your testimony, I believe, that the device might help somebody if the metatarsal elevation happened to be correct. Now, will you explain how that is? A. Well, the metatarsal elevation is the elevation in the front part of the foot, in the region of the ball of the foot. It is here (indicating).

Mr. Maury: The witness is indicating Exhibit 3.

Trial Examiner Haycraft: Which end?

Mr. Maury: The end that is not marked. One end is marked '3.' He is indicating the unmarked end.

Trial Examiner Haycraft: All right.

The Witness: On this cuboid support we can see that there is an irregular elevation.

Now, on the average human foot, the depression of the metatarsal arch might not follow that particular pattern. As I explained before, it may be in the region of the first metatarsal head or the second

or the third metatarsal heads, or it could be in the region of the fifth metatarsal.

Now, if perchance this portion (indicating) of the support should strike the portion of the metatarsal arch which requires building up, then this would give that patient some relief."

[II R. 41, line 3, to 47, line 7]:

"Q. Now, Doctor, you said there was a great connection and a very important connection between foot balance and body balance. A. Yes.

Q. Then, now, will you expand upon that subject, will you explain what you mean by your statement distinguishing between foot balance and body balance, those two terms? A. Well, now, when you speak of body balance, you are speaking of the entire human system. Foot balance deals only with balancing the foot.

Q. Good, and the balancing of the foot is the —is what? What is it, Doctor? A. Well, it is the maintenance of good equilibrium through neuromuscular control through the muscles and other structure of the foot, through nerves.

Q. Well, now, isn't that body balance? A. Well, foot balance and body balance are not the same.

Q. Well, that is what I am seeking to elicit, that is what is foot balance and what is body balance? A. Foot balance is balance of the foot; body balance is balance of the entire human body.

Q. In other words, if I may say so, the foot balance is the balancing of the foot upon its sole and its heel, isn't that correct? A. Yes.

Q. And the body balancing is the balancing of the entire body up from the foot, from the tibia or

leg bone and up? A. Well, body balance takes in the entire body, including the feet and legs.

Q. I would like to have the distinction clear between the two terms that you use. One of them has reference, I think, if I am correct, to the balancing of the foot upon the surface upon which one is standing; and the other, namely, body balance, has reference to the balancing of the body upon the foot and up, is that true or not true? A. Well, I think I am not making myself clear to you. When I speak of a person having good body balance, I am speaking of the entire body, including his feet, so you cannot speak of body balance as being balancing of the upper part of the body upon the feet. I speak of body balance as complete balancing of the body.

Q. Well, body balance includes foot balance, is that your conception? A. Yes.

Q. Now, then, the foot is not perfectly flat on the surface is it, under the surface? A. No.

Q. For example, the heel is rounded, is it not, on the under surface? A. Yes.

Q. And the heel is at one end of the foot and as you move further along the foot you have the outer side of the foot which forms the surface upon which the person is standing, and you also have the inner side of the foot? A. Yes.

Q. And the inner side is what you describe as the longitudinal arch, that is where the longitudinal arch is? A. Yes.

Q. And then after passing forward from that, if you are examining the foot, after you pass the arch you come to the metatarsal heads which are what is known as the ball of the foot? A. Yes.

Q. And after that there are the toes? A. Yes.

Q. Right. Now, will you describe for the record dynamically how the weight of the body is distributed upon the foot as a person walks? A. Well, the weight of the body is first thrust on the heel and then as he goes forward the weight is taken through what is known as the midtarsal bones and the bones in the midportion of the foot, and then on through the metatarsal area and through there into the toes. In walking forward there is very little weight taken on the midtarsal area, it is distributed almost immediately on the first and fifth metatarsal heads and there is practically no weight borne on the toes.

Q. Now, then, the heel is what we call the calcaneus, is it not? A. Yes.

Q. And the metatarsal heads are the low parts of the foot? A. Yes.

Q. And the arch between the heel and the metatarsal heads is the upper part of the foot, the upper part of the bottom of the foot, is it not? A. That is right.

Q. In other words, the structure of the foot longitudinally or lengthwise is somewhat arch-shaped? A. Yes.

Q. Now, when the weight of the body is upon the foot, where is the focal point of the weight borne? A. The heel.

Q. Through the calcaneus? A. Through the talus, the calcaneus, the heel bone.

Q. And as the body weight moves forward, the weight is transferred forward—now, what is the keystone of the arch? A. The talus.

Q. The talus? A. Yes.

Q. And what is next to the talus—will you describe the cuboid bone in detail? A. Well, the cuboid bone is an irregularly shaped bone located

between the calcaneus and the fifth metatarsal bone. It articulates with various other bones, the fifth metatarsal and the fourth metatarsal bones. It articulates also, with the calcaneus, that is the heel bone and to a very slight degree, I believe, with the scaphoid.

Q. In general, the cuboid bone is shaped somewhat similar to, roughly, to a cube, is it not? A. Yes.

Q. Hence, its name. As a person stands up on his toes, as distinguished from flat-footed, there is a tension, is there not, to the sole of his foot? A. Yes.

Q. Or rather to the ligaments, the leverage falls on the tendons, does it not? A. The ligaments and the tendons.

Q. And the bones act as the structure upon [which] the forces of the muscles operate? A. The forces operate on the bones, chiefly.

Q. There is a tension between the metatarsal head and the heel and up the leg when a person stands on the soles? A. Yes.

Q. That is, a tendency to pull in the metatarsal heads toward the heel? A. To a slight degree.

Q. Very slight, but at the same time there is such a tension because of this articulation which you have mentioned, that is, the articulation of the cuboid with other bones, there is such a tendency, slightly? A. Yes.

Q. And when a person is standing flat on his heels and toes the tension will be the other way, will it not? A. That is right.

Q. In other words, when you stand up the longitudinal arch tends to draw its ends together? A. Yes.

Q. And when you stand the other way, the arch tends to flatten out? A. Well, I wouldn't say the arch flattens.

Q. I say it tends to, I did not say that it flattens. In other words, the ends stretch? A. Yes.

Q. It is something like a bow and arrow, isn't it, when you put a strain the ends of the bow come together and when you release it, the ends go apart?

A. Yes, but that is so slight that it is almost negligible, because you have a boney arch, you can't follow the description of a bow and arrow.

Q. It is analogous, but of course the analogy is not perfect. I understand that. I was using it as illustrative to the point; but there is there motion? A. Yes.

Q. Which is in the foot; in other words, the foot flattens out slightly? A. Yes.

Q. And, of course, that is constant process, this arch rising and falling, is that not true? A. Yes."

[II R. 51, line 20, to 51 [2d] line 22]:

"Q. Now, Doctor, you testified in your direct that sometimes there was relief of pressure which could be effected by the cuboids. Would you explain that? A. Well, I explained that. If the elevation in the metatarsal area struck—that is, if the device happened to strike behind the area that is being depressed in the metatarsal area, then the patient will be afforded some relief.

Q. Well, how does that happen that the patient does obtain that relief, psychologically or physically or in any other manner? Will you tell us how that relieves it? A. Well, in the region of the metatarsal head you have a certain amount of flexibility, you can take the metatarsal heads and push them up and down.

Q. That does not explain to me how this pad under the metatarsal head will relieve the pain there. I would like to know that. A. It relieves pain by taking pressure away.

Q. Taking pressure off the head? A. That is right.

Q. And transferring to some other portion of the foot? A. That is right.

Q. And that relieves the pain? A. That is right.

Q. Now, the pressure, of course, that produces the pain is registered in the brain by the nervous system, isn't it? A. Yes.

Q. And it is the pressure on the nerve ends that is relieved? A. Yes."

[II R. 54, line 23, to 57, line 8]:

"By Mr. Maury:

Q. I will call your attention, Doctor, to this diagram, which is Exhibit A, attached to the answer of the respondents, will you examine it, sir? A. Yes.

Q. Can you tell us whether or not, in your opinion, those arrows indicate the movement of the pressure of the weight on the sole of the foot as a normal person walks forward and the relative heaviness of the arrow indicates the relative amount of weight? A. No, I think that is an incorrect statement, I don't think that it indicates the amount of weight that is falling on the foot.

I think it might indicate the amount of compression that it gets, that is, upon the soft tissues.

Q. That is, you do not admit that this diagram correctly describes as nearly as it can be graphically described, the progress of the weight bearing of a foot as a person takes a step? A. Yes, it does

indicate the progress of weight bearing but not the amount of weight bearing.

Q. And the pressure lines in the diagram, assuming that these lines are pressure indications and are supposed to represent the weight relatively to the heaviness, the heavier lines representing the heavier weights—it is your opinion they are incorrect? A. Yes. The amount of weight which is borne on the soft tissues is not analogous to the amount of weight which is borne on the boney arch.

Q. Which is to say, this more nearly represents the weight borne on the arch or the weight borne on the soft tissues? A. The weight borne on the soft tissues.

Q. Does that truly represent, then, the relative weight borne on the soft tissues as one takes a step forward? A. Yes.

Q. Now, the soft tissues, of course, underlie the foot, do they not? A. Yes.

Q. And they are composed of the skin and the various other tissues which you have described, the muscles and tendons? A. Yes.

Q. Including all of the other components of what we designate ordinarily as flesh. And it is on those soft tissues and the boney structure that the weight falls, to a greater or lesser degree? A. Yes.

Q. And this does, then fairly represent the transmission of weight as it is on the foot's soft tissues? A. No, I can't agree with that because I believe I have answered that question once already, that the impression does not indicate the amount of weight that is borne. I will say that the weight is transmitted through the soft tissues to the bone, but it does not indicate the amount of weight which is borne because you have some cavities that are present in

the inner longitudinal arch and you would have no way of knowing how much weight is being borne in that particular area. That indicates the weight pressure on the soft tissues, it does not indicate the weight pressure on the boney arch.

Q. I see, but it does fairly indicate the weight pressure on the soft tissues as the person steps forward? A. Yes."

[II R. 60, lines 5-12]:

"Q. Doctor, I think you indicated that in certain exceptional or unusual cases you could conceive of some slight relief where a device such as cuboids might influence the pressure on the metatarsal area, isn't that correct? A. Yes.

Q. Now, what would you say as to whether or not that possible relief would be temporary or permanent? A. As a rule it is temporary. It could be permanent."

[II R. 62, lines 4-12]:

"A. Well, the average person wears the heel a little to the outer side. As far as the sole of the shoe is concerned, it varies too much to be able to state which side wears the most. In examining shoes, and I have examined the soles of practically the shoes that I see, it has been my impression that where the feet are normal, the sole is worn equally, with the heel a little to the outer side.

Q. The heel on the outer side, and the sole equally? A. Yes."

DR. MASTERSON (For the Commission).

[II R. 68, line 19, to 69, line 8]:

"Q. In your opinion, Doctor, what sort of foot trouble, if any, would be benefited by wearing the

Cuboids? A. Well, there might be an occasional case with a small metatarsal elevation and elevations in the cuboid and scaphoid area where, through a happy circumstance, that happened to be an exact fit, where with a mild metatarsal depression in the region of the third metatarsal head, it could help.

Q. What extent would that help be? A. Well, if it happened to fit right, it may give the patient a fair amount of relief.

Q. By easing the pressure? A. By easing the pressure.

Q. Would that mean that it throws that pressure elsewhere on the foot? A. No, not necessarily."

[II R. 72, line 25, to 73, line 12]:

"Q. Could the wearing of Cuboids be of any help in obtaining body balance or foot balance, in your opinion? A. I don't see how—It might in a rare instance, but as a rule, no.

Q. Well, what sort of a rare instance do you have in mind? A. Well, if there happened to be a real, good fit and an actual need for some balance in the metatarsal area, this might, all other factors being considered, it might help in an occasional case.

Q. Well, you say 'actual need.' Who could determine the question of that actual need? A. I feel that that should be determined by a man who is well trained and versed in foot pathology."

[II R. 73, line 5, to 85, line 6]:

"Q. Now, let us go into this 'happy circumstance' which you mentioned, where you said that sometimes the use of this device might aid in relieving a metatarsal pressure situation. Will you explain that thoroughly to the Commission? A. Well, if it happens to fit correctly and the particular person hap-

pened to have a foot which was adapted to this device, then the position of this metatarsal pad might hit the right spot, but that certainly would be asking for a lot of coincidences to occur, which we cannot ask for, as a rule.

Q. Now, Doctor, I will draw your attention to the elevation in this Commission Exhibit 3 here (indicating), the one beneath the cuboid bone, when pressure is put on that; do you understand that that falls into a depressed or concave pattern? A. Yes.

Q. And what effect does pressure upon the cuboid bone have— A. I wouldn't say it had any.

Q. Wouldn't you support that area slightly? A. What for?

Q. I didn't ask you what for; I said does it or does it not tend to support that area underneath the cuboid and the anterior end of the fifth metatarsal?

A. *It is practically balanced by your support on the other side.*

Q. The support given by the cuboid? A. No. You have got one on each side, so that they almost negate themselves.

Q. How do you mean, 'negate themselves'? A. Well, I mean if you put a one-inch lift on one side and a one-inch lift on the other side and put them together, you still have not raised them, or very little, if you are trying to elevate one side or another.

Q. I don't think you are answering my question. Doesn't it support— A. I don't feel that it does.

Q. You do not feel that it support to the benefit of the cuboid and the fifth metatarsal? A. I don't feel that it does.

Q. What does it support? A. It doesn't support anything.

Q. It is underneath the foot? A. It is underneath the foot.

Q. And you say it does not support it? A. I don't feel it does.

Q. But the foot rests on it? A. The foot does rest on it.

Q. And if it did not support— A. But it also rests on the other lift that you have on the other side.

Q. Well, isn't that supported? A. The two *balance each other*, and I feel that they don't support." (*Italics ours.*)

[II R. 86, line 14, to 87, line 19]:

"Q. Now, Doctor, in the course of that step does the cuboid bone bear any of the weight of the body? A. It bears the same amount of weight, I would say, as any of the other bones of the foot.

Q. The foot is adjusted so that the weight is distributed? A. That is right.

Q. And if that is out of place, the foot will be uncomfortable, will it not? A. That is right.

Q. The cuboid bone is shaped roughly as a cube? A. That is right.

Q. And, in fact, it is sometimes referred to as the keystone of the arch? A. No, I believe you are misquoting somebody, or, I am not acquainted with your quotation. I believe the one I am familiar with and have been taught in school is that the naviculus is the keystone of the arch.

Q. Now, how many arches does the foot have? A. Well, it can be broken down into several.

Q. Well, break it down. A. Well, some people feel that there is the longitudinal arch which we have already discussed, and that is considered by most of

us, in my opinion, as the most important and which is also the anterior or metatarsal arch; and some people also speak of the longitudinal arch as being in two parts, an inner longitudinal and an outer longitudinal. The inner longitudinal which they describe I have already discussed, and the outer is composed of the os calcis, the cuboid and the cuneiform and the fifth metatarsal.

Q. That is the outer arch? A. Yes."

[II R. 97, lines 14-23]:

"Q. Well, let us assume a person is wearing shoes which are ill-fitting and then changes to a pair of shoes which do fit him, would it be your opinion that the second pair of shoes will have helped that fatigue? A. Yes.

Q. And if he has less fatigue that would result in less aches and pains over the body and that would affect his poise and balance, won't it? A. He would have better balance; as far as poise is concerned, you will have to define that."

DR. MOSIMAN (for the Commission) [I R. 110, lines 7-12]:

"Q. What relationship does the cuboid bone have to the balancing of the foot? A. Well, it is one of the several major bones of the foot which entered into foot motion and therefore in some degree into foot balance, but it is no more important than a good many other bones."

[II R. 114, lines 20-25]:

"Q. What are the most appropriate places on the foot for weight bearing, in your opinion? A. Well, the entire sole of the foot is adapted for weight bearing but usually in the normal foot action, less weight

is borne on the medial side of the foot than on the ends of the toes and heels *and lateral side of the foot.*" (Emphasis ours.)

[I R. 125, line 19, to 129, line 17]:

"Q. Then, as I understand it from that, the surface that the foot walks on is a very important factor as to whether or not the person will have foot trouble?

A. Yes, that is right.

Q. Now, isn't it likewise true of foot balance, that the surface the person walks on and its contour is important to foot balance? A. Yes, with certain modifications.

Q. Will you state the modifications? A. Well, we wear shoes; our ancestors did not, and although one sees a considerable amount of foot disability in people who don't wear shoes, still the walking on soft ground is a drastically different matter from walking on stony ground and hard floors, and those surfaces may give cause, or should be considered.

Q. Yes; so that the surface that the person walks on is important; and that surface is the inside of the shoe, isn't it? A. That is true.

Q. And if that does not conform to the surface of the foot, what is the result? A. Well, usually it does not conform to the surface of the foot, with happy results.

Q. With 'happy results,' why is that? A. Because a smooth surface without inelastic molding in it is best, and the inside surface of the shoe may be that, so that people with that type of shoe get less trouble than the others.

Q. And what are the others— A. Well, as I mentioned, a shoe with a filler which models to the foot very frequently will cause trouble because the modeling becomes inelastic and gives the patient a considerable amount of pain.

Q. Then, as I understand it, a new shoe should be more comfortable than an old shoe. A. Providing it fits properly.

Q. Well, supposing it doesn't fit properly, will it be more comfortable to wear a new shoe or a shoe that was worn for a long period of time by the same wearer? A. Well, that is within the limits of properly fitting the new shoe; then the new shoe will be more comfortable than the one which has an uneven sole and has been worn.

Q. It seems to be the type of shoe that you start with. It is your testimony, then, that the new shoe will be more comfortable than the old shoe? A. Yes. Let me arrange that a little, if I may.

Q. Please do. A. We were talking about shoe soles which model to the foot.

Q. Yes. A. And then we came to new shoes and old shoes.

Q. That is right. A. A good quality shoe will not model to the foot and an old shoe will be fully as comfortable and probably more so than a new shoe if the fit is the same.

Q. Why will the old shoe be more comfortable? A. Because the leathers will be softened with use and have more elasticity and give.

Q. And will be adapted more to the shape of the foot; is that it? A. To the top surface of the foot.

Q. You mean the bottom surface or the top surface of the sole? A. No, indeed, I wasn't speaking of the sole, I meant the upper portion of the foot. Now, if I may give an example.

Q. Please do. A. I have a pair of shoes which are fairly new and which are pinching a toe. Now, in a few weeks' time they will not pinch me as much as they do now on the top surface of the foot.

Q. Now, this statement you made about a person walking on bare ground, or I believe you used the term 'soft ground,' let me inquire a little bit into that.

Will you tell me the difference between walking on bare ground and walking upon sidewalk, and so forth?

A. Well, the difference in that is that ground, generally speaking, with the exception of rock, gives somewhat to the foot and there is more resilience, particularly as the person steps down on the heel and when the full weight of the body is borne or the shock, as the heel hits on the bare ground than on the pavement, and that resiliency is particularly apparent in the difference between people who don't wear shoes and people who do.

It is the reason, for example, along with other mechanical reasons, why a man running finds it much more satisfactory to land on his toes than on his heels.

Q. That is, as I understand it, on the bare ground with bare feet, when the heel will press on the ground first; is that right? A. Ordinarily speaking, yes.

Q. There is more resiliency on the ground, unless it is rock, you say? A. Yes.

Q. And as the step is further taken, the weight is transferred forward on the foot? A. At the moment of step-off, it is true.

Q. Yes, the amount of the step-over or step-off, the weight moves over to the metatarsal area? A. And the toes, yes, sir."

[II R. 130, line 13, to 133, line 16]:

"Q. Now, is it true that many backaches and leg pains or even some classes of headaches are caused by trouble with the feet? A. I think that is true; yes, sir, that is right.

Q. And you have already testified that many foot troubles originate in improperly fitted shoes? A. Yes.

Q. Now, is it true that callouses, in the ordinary lay language, are caused by frictions? A. Yes.

Q. That is, the rubbing of the shoes, or what have you, on formation? A. May I say a little about that?

Q. Yes, sure. A. Not only the rubbing of the skin against the sole, but—it may be caused, for example, by the rubbing of the skin against the rake handle, but also by rubbing of the bone internally against the skin through the sole pad.

Q. Yes. It is the rubbing of the two hard surfaces on a soft surface? A. Yes.

Q. And nature protects the soft surface by the growth of the callous, and the callous is usually produced by that need? A. Yes.

Q. Now, callouses will be largely produced on what area on the foot? A. Frequently in the metatarsal region, that is, up under the base of the toes and also frequently on the tops of the toes—you have corns then.

Q. That is, when the shoe is rubbing on the top of the toe? A. Yes.

Q. Well, that is not part of the weight factor, is it? A. No, that is pressure of the shoe.

Q. But, the callouses on the sole of the foot are from the weight factor; isn't that so? A. That is right.

Q. Now, is it not your custom, in your diagnosis of foot troubles, to find that they require some sort of a support at various points? A. Yes, definitely.

Q. And what different types of support do you use? A. Well, we usually have a combination of

supports. It depends entirely upon the patient's foot, you understand.

Q. Sure I understand. A. Some people need no support inside the shoe whatsoever; a wedge in the sole or in the heel may suffice to make the alignment, whereas with some other people, particularly those who have callouses, they very frequently need temporarily a support within the shoe to relieve pressure from the area of the callous. That can be done by any one of several types and some of them are made of rubber or cork and sometimes we use a felt pad with a hole in it placed over the area of the callous.

Q. The hole is for ventilation purposes? A. No, the hole is actually to relieve pressure from the callous.

Q. Yes, I see. A. So, the thing acts like a doughnut; the hole in the doughnut is placed over the callous.

Q. That is to transfer pressure from the callous to another area? A. That is right.

Q. Yes, and these supports can be placed according to your diagnosis under any portion of the sole? A. Well, yes, that is right.

Trial Examiner Haycraft: What do you mean by 'portion of the sole'? Do you mean the sole of the shoe or the sole of the foot?

Mr. Maury: Sole of the foot, I meant.

By Mr. Maury:

Q. I think you understood that? A. Yes, I would like to qualify that a little.

Q. Yes. A. I have never had occasion to place the pads of the felt type on the medial side of the foot; I have used the rubber support.

Q. Which is the medial side? A. The inside portion."

[II R. 135, line 4, to 140, line 6]:

"Q. Whereabouts, in ordinary lay language, is that located in the foot? A. In the region of the cuneiform bones in the midtarsal region of the foot, that is the area before—below the ankle foot and in front of the toes directly across the top of the foot.

Q. That is what we usually indicate as the instep, isn't it? A. Yes.

Q. What bones is that composed of? A. The heads of the metatarsals, of the toes, the first and the fifth; the first, second and third cuneiform and the cuboid bone and the front end of the os calcis may enter into it, although most people say it does not.

Q. It is rather a complex arch, is it not, Doctor? A. Yes.

Q. And which bone in that arch is the lowest one in point of closeness to the surface when the foot is flat? A. The cuboid and the heads, or I mean the base of the fifth metatarsal, which are contiguous.

Q. Yes, they are right together on the outside of the foot? A. Yes.

Trial Examiner Haycraft: You say the base?

The Witness: The base of the fifth metatarsal and the cuboid are on the bottom of that group of bones.

By Mr. Maury:

Q. Now, what bones compose this outer arch, that is, the arch on the outside of the foot? A. The fifth metatarsal, perhaps part of the fourth metatarsal, but the fifth metatarsal, certainly, the cuboid and the os calcis.

Q. Now, is it true that the forces of thrust as the weight is taken off the foot in stepping, will concentrate upon the cuboid bone in both of these arches?

A. No, I don't think so.

Q. You don't think so. Where does it concentrate as the weight moves from the heel to the metatarsal? A. Well, I don't believe it concentrates at any point in the manner that you have indicated. The weight is first borne on the heel.

Q. Yes. A. There is a good bit of the weight borne on the lateral side of the foot and then on the ends of the toes as the foot comes forward in walking. In standing, it is a different matter.

Q. Yes. A. However, when one says 'arch' one thinks of a Roman arch with a keystone in it, and that is not true of the foot at all.

Q. Will you explain, please the difference? A. Gladly. A Roman arch has a keystone, it is an architectural type of arch, and it means that when the keystone is placed in the arch it holds all the rest of the arch in position and the greater the amount of the weight that it put on it the harder that arch will hold until you reach the point that the stone will actually crush from the weight; and that is why some of the Roman buildings, many of them, are still standing today.

Q. That is a completely static piece of architecture? A. Well, I think—I am not an architect, but once it is set up, unless you knock the supports from under it, it is likely to be there a good while.

Q. Yes. A. Now, the foot arches are supported by ligaments and muscular structure, unfortunately, and that is why so many people have trouble with them, and it isn't a question of pushing the weight on one or another end of a keystone type of arch and having all of the stress concentrated at one point.

Q. That is a dynamic situation as compared to static? A. Yes.

Q. In other words, the foot is designed and built by nature for walking? A. That is right.

Q. Whereas the arch in architecture is designed to hold up an edifice? A. That is right.

Q. And that is the fundamental difference that you are trying to elucidate for me? A. Yes.

Q. And the arch of the foot, I take it, is more like a bow and arrow; is that right? That is, there are stresses and strains as in a bow and arrow which I use for illustration, and it is a very complex structure, is it not? A. That is right.

Q. And one in which are found many interwoven forces, stresses and strains; is that not true? A. That is true.

Q. Now, Doctor, what is the general effect of high heels? A. Well, one of the most common things is that a girl who from her youth has worn high heels by habit and who very seldom has worn anything else, she will have actual tightening and shortening of the calf muscles or the back of the leg, so that the time comes when she can no longer wear low heels or walk barefooted.

Q. That is, without strengthening of the muscles? A. Well, when any such strengthening is indicated, it is better to fit her with a moderately high heel and let her just take the shortening that she has rather than put her through surgical procedure.

Q. Now, that is the effect on the leg; what is the effect on the foot? A. Very frequently one will find that the muscles of the bottom of the foot have been considerably damaged by this prolonged high-heeled position.

Q. What is the effect upon the area of the metatarsal head or the ball of the foot? A. Well, the ball of the foot—sometimes there will be callous formations, although I don't believe the majority of the women that, day in and day out—and most of them, a great preponderance, have an inswing of their toes, the big toe and the little toe, and frequently an overlapping of one of the middle toes, usually the second, caused by the high heels, making them slide up and down in the shoes.

Q. Do you ever utilize foot pads or sole supports in the area of the shoe for that type of trouble? A. We sometimes do, yes.

Q. And where do you apply them? A. Well, I generally apply *them just behind the metatarsal region*; but for them to be effective it is necessary to put as low a shoe as possible on the woman; in other words, we get a pair of shoes with relatively low heel, usually not higher than an inch and a half, in order for the pad to be effective. If we try to put such a pad in high heel shoes, there will simply be a slipping forward away from the pad, which will have no effect. (*Italics ours.*)

Q. That is, you will have to lower the angle at which the shoe presses on the sole of the foot? A. Yes."

[II R. 142, line 22, to 143, line 23]:

"Q. Now, is it true, Doctor, that the arches of the foot were designed to be strongly supported at every step by this ground situation you have discussed? A. No.

Q. It is not? A. No.

Q. They are supposed to give and take and be molded to the surface as it exists in nature, as the step is taken? A. As the step is taken, as the foot

is designed it is molded by the surface that it meets and adapts to it as it goes to the next step.

Q. Now, would you say that a flat surface is best for the foot? A. Generally speaking, yes, more or less; I can't say yes or no on that; I can qualify it.

Q. Well, is a flat surface good for the foot? A. Not necessarily, no.

Q. What do you mean? Will you qualify it or give an explanation? A. Well, there is considerable difference, for example, in standing on wooden floors and on concrete floors. Very frequently if a man is working, standing on a concrete floor, in order to prevent shock, he will get himself a piece of rubber or a board to stand on.

Q. That is, rubber gives a little more, doesn't it? A. Yes, it does."

D. The Therapeutic Claims.

Six witnesses appeared for the Petitioner who had had *personal experience in using the device*: (1) Miss Ruth Kerr [II R. 156-205] was a specialist in the shoe industry, a consultant for Good Housekeeping Magazine, an adviser on leather shoes, and had made a special study of the device to determine whether it had merit as claimed.

It is remarkable indeed that after this special study, she became an emphatically enthusiastic user of the device herself; and after giving her opinion testimony, also gave her experiential testimony. At II R. 80, she states, "It made me feel more comfortable and more poised"; "The balance of the body was adjusted better, and the balance of the foot itself was improved." She could do a great deal of walking with much more ease than before she

wore the appliances, and in all respects her experience bore out the advertising claims.

(2) *Dr. Cassius E. Paul* [III R. 593, *et seq.*]; and (3) *Dr. John W. Wilson* [III R. 505, *et seq.*] were both members of the dental profession, forced to stand upon their feet for long working hours of the day. Both of them testified to the value of Burns Cuboids to them in their work and to the elimination of aches and pains and to the relief of their tired and aching feet.

(4) *Warren E. Woody* [IV R. 640, *et seq.*] and (5) *Harry L. Hanson* [IV R. 629, *et seq.*] had had similar experiences.

(6) *Dr. Garner* [III R. 558, *et seq.*] had found displacement relief from the pain caused to his leg by his foot, and as such, in this respect, was an experiential witness also.

In this connection, it is notable indeed that *no single member of the consuming public was produced by the Commission who had any complaint whatsoever to make concerning Burns Cuboids. Not one person came forward to say that he was dissatisfied with the device. No complaining witness ever appeared.* No irate patient of either of the Arlington doctors ever corroborated these worthies!

Instead, the complaint is based entirely upon the allegation by the Commission that "the Commission has reason to believe" that the law is being violated [I R. 2]. Out of a million customers [II R. 301], nobody (except

the Federal Trade Commission) from the record, "had reason to believe" that we have said anything false.

As "therapeutic" claims, the proscribed advertisements are certainly innocuous in the extreme! These claims are: that Cuboids *relieve strain and fatigue* [I R. 17]; that better poise and balance replace *aches and pains*; they drive away *foot fatigue*; they are the modern way to *foot relief*; they . . . *lessen fatigue*; they afford effective *relief to aching feet*.

These are the "therapeutic" claims proscribed by the order of the Commission [I R. 184-185].

Yet the Commission also [I R. 182-183] *found* as follows:

"(b) The Complaint also charges that respondents have represented that the use of Cuboids will afford relief to strained, tired feet and alleges in such connection that the respondents' device possesses no therapeutic value as an aid to strained, tired feet. The greater weight of the evidence adduced in this proceeding does not support the conclusion that respondents' device possesses no value as an aid to strained, tired feet and the Commission is, accordingly, of the view that the charges relating to this issue of the proceeding should be dismissed."

And [I R. 180] the Commission also finds that

"respondents' device is not an effective treatment for ordinary foot aches and pains and has no therapeutic value in the treatment of aching or painful feet."

Quære: With all due respect to an agency of the United States, is this a mere play upon words? Just where do “strained, tired feet” end as a condition and “ordinary foot aches and pains” begin? Is it not common knowledge that when one’s feet are strained and tired, one will have ordinary foot aches and pains? Therefore, is not the Commission again inconsistent in its findings?

Again, with all due respect to the Federal Trade Commission, and with apologies to this court for the use of an expression purely of the vernacular, is this anything but “double talk”?

Too, we urge, the Federal Trade Commission has forgotten the maxim: “*De minimus non curat lex*”—*the law disregards trifles*.

Compare, for example, the advertising claims made in the case of *Irwin v. Federal Trade Commission*, 143 F. 2d 316. The device therein discussed was entitled a “detoxifier.” It was, in essence, not much more than a device to administer enemas. The advertising claims therein were as follows:

“This natural and drugless therapy performs as follows:

“‘1. Cleanses both large and small bowel, thoroughly and in a harmless manner.

“‘2. Massages the bowel and gives necessary tone to tissues involved.

“‘3. Its employment of oxygen destroys the anaerobic germs, which can not live in this medium.

“ ‘4. Purifies the blood stream; proved by microscopic examination after treatments.

* * * * *

“ ‘6. Reduces hypertension or high blood pressure, thus easing the work of the heart and freeing the walls of its cells, and the brain, from undue strain.

“ ‘7. Indicates to patients what foods to avoid to insure maximum efficiency in digestion.

“ ‘8. Lessens the burden thrown on the liver and kidneys.

“ ‘9. Improves sinus—and antrum complications in a few treatments.

“ ‘10. Re-establishes a normal persistalsis, or natural muscular activity of the intestines.

* * * * *

“ ‘12. Assists in preventing the hardening of the arteries, by minimizing the deposits of calcium and magnesium salts on the walls.’

“A pulsating stream of water and air bubbles is introduced into the bowels in a scientifically controlled manner. This pulsating stream penetrates readily into the small intestine, hitherto inaccessible to any other method of treatment. Most ailments are found to originate in the small intestine.

“Ozone is especially beneficial in cases of ulcers, colitis, bowel inflammation and toxemia.

“Ozone destroys bacteria on contact yet it is not a drug and is non-toxic and non-irritating. It promotes healing and stimulates.”

“Specializing in Cases of
Intestinal Toxemia.

The Cause of Most Human Illness.

“The following symptoms and ailments are almost invariably caused by Intestinal Toxemia. They can now be successfully treated.

Appendicitis

* * *

Asthma

Colitis

Constipation

Excessive Fatigue

Foul Breath

Headache

Gall Bladder Complications

High and Low Blood Pressure

Indigestion

Irregular Heart

Kidney and Bladder Complications

Liver Complications

Lumbago

Menopause Disturbances

Muddy or Pimply Complexion

[Migrain]

Nervousness

Pruritis ani

Rheumatism

Sinus Trouble

Run Down Condition

Short of Breath

Sleeplessness

Ulcers of Stomach and Bowels

Ulcerative Colitis.”

It was, we submit, this type of therapeutic claim that the law was designed to prohibit. An attack, such as

in this case, by the great and powerful Federal Trade Commission upon a small, legitimate, upright manufacturer, with its attendant expense, uncertainty, and worry, over something so close to the truth (conceding for arguments sake, without admitting, the Federal Trade Commission's position) that the Commission itself cannot make a definitive distinction without confusion and inconsistencies in its own findings, has, we submit, taken the whole process far, far afield from its original design and purpose!

We respectfully submit that the Commission's findings are again not only lacking in substantial evidence as to "therapeutic" claims but that actually the findings are completely unfounded upon *any* evidence.

E. Callouses.

The Commission found: "Cuboids will not be generally effective in treating or relieving calloused conditions" [I R. 180]. The Commission ordered the Petitioner to cease and desist when advertising "that said device possesses therapeutic value in the treatment of calloused feet."

In these matters the Commission differed from *all* of the experts. Dr. Engh testified [II R. 51] with respect to the metatarsal bar which is incorporated into the Cuboid:

"Q. That does not explain to me how this pad under the metatarsal head will relieve the pain there. I would like to know that. A. It relieves pain by taking pressure away.

Q. Taking pressure off the head? A. That is right.

Q. And transferring to some other portion of the foot? A. That is right.

Q. And that relieves the pain? A. That is right.

Q. Now, the pressure, of course, that produces the pain is registered in the brain by the nervous system, isn't it? A. Yes.

Q. And it is the pressure on the nerve ends that is relieved. A. Yes."

Dr. Masterson testified [II R. 68-69]:

"Q. In your opinion, Doctor, what sort of foot trouble, if any, would be benefited by wearing the Cuboids? A. Well, there might be an occasional case with a small metatarsal elevation and elevations in the cuboid and scaphoid area where, through a happy circumstance, that happened to be an exact fit, where with a mild metatarsal depression in the region of the third metatarsal head, it could help.

Q. What extent would that help be? A. Well, if it happened to fit right, it may give the patient a fair amount of relief.

Q. By easing the pressure? A. By easing the pressure."

And at II R. 82-83, we find the following:

"Q. Where are callouses, generally? A. Generally in the metatarsal area.

Q. Metatarsal area? A. Metatarsal area; that is right.

Q. In the area where you are bearing weight? A. Where you are bearing weight, yes.

Dr. Mosiman [II R. 131-133] testified that the genesis of callouses is due to friction; that they are largely on the metatarsal area of the foot; that a support is needed

to relieve pressure from the area of callouses. Sometimes these are made of rubber or cork or a felt pad placed so that it will relieve pressure from the callouses, and transfer pressure from the callouses to other areas.

At pages 139-140 it appears that Dr. Mosiman applies foot pads just behind the metatarsal region.

Dr. Hiss [II R. 246-247; II R. 264] states that the forepart of the Cuboid is nothing but a modified Thomas Bar which, by being placed just back of the callouses or the weight bearing part of the ball of the foot, will assume some part of the weight by pressing up on the foot and relieving some of the weight on the ball of the feet. That is what happens when you use a metatarsal pad, a Thomas Bar, or any kind of a bar that will assume some of the weight and take it off of the callous.

Dr. Garner gave out the same idea [III R. 567], and Dr. Lewin was most explicit in his description of the device [IV R. 847-848] in which he describes a "Jones Bar" as a strip of metal on the bottom of the shoe sometimes attached to or incorporated in the sole of the shoe—a straight object that goes behind the first and fifth metatarsal bones, that is, the heads of them.

Dr. Lewin at IV R. 936-939 explains what he designates as a "Lewin Rubber Metatarsal Crescent." This is a curved object to correct a curved structure or to support a curved structure as illustrated in Respondent's Exhibit 29 in Evidence. It is a modification of the shoe; its purpose is to relieve people of weight bearing on certain areas, to give them some degree of comfort, and to balance their feet more properly.

He discusses the Commission's Exhibit 3 in Evidence, the forward section thereof, and states that this is similar

to the Lewin Rubber Metatarsal Crescent. This raises the metatarsal area slightly, and the purpose is to transmit the weight from the heel to "an area back of the metatarsal heads and relieve those heads of pressure." It is a weight bearing point so that the person transmits his weight from the heel to an area just back of the metatarsal heads, instead of having the weight come down on the metatarsal heads.

It is to relieve pressure or weight on the metatarsal heads; it takes weight off the metatarsal heads; it might and should help callouses on the metatarsal arch area. The Lewin Crescent is a very frequent prescription, and Dr. Lewin always sends these *to the shoemaker to have them executed*.

At IV R. 940, it appears that the object is to give the person relief from foot pains, foot discomfort, to aid balance, to improve stance, to take weight bearing off the sensitive parts of the feet, and to transfer it to other parts of the feet. All this, according to Dr. Lewin, tends to relieve callouses.

Since there is no word to the contrary in the entire transcript, we submit that the above mentioned finding and the order are without foundation of substantial or *any evidence*.

F. Dr. Lewin, in Fact, Might Easily Have Been the Inventor of the Device.

While he was a witness hostile to the Petitioner, nevertheless Dr. Lewin, from his own testimony and methods, might easily have been the inventor of the Cuboid.

The Cuboid [Com. Ex. 3, Pet. Ex. 1] has as its distinguishing features:

1. A crescent-shaped elevation across the front, which fits just behind the metatarsal heads, and takes the pressure off these heads. [See Ex. 33-B, Dr. Lewin's diagram.]
2. Wedge-shaped elevations along the sides at the point of the heel [see Exs. 29, 1, 2, 3, 5, 7, 9, Dr. Lewin's illustrations; Ex. 3, Dr. Lewin's method].
3. 200 different varieties of combinations of these elements.

Dr. Lewin explains his devices as follows [IV R. 937]:

“By Mr. Maury:

Q. Calling your attention to this page, the diagrams demonstrate types of bars and pads? A. No, modification of shoes.

Q. Modification of shoes? A. Yes.

Q. What is the general purpose of these modifications of shoes? A. To relieve people of weight bearing on certain areas, to give them some degree of comfort, and to balance their feet more properly.

Q. You have found throughout your experience that these devices are effective in that respect? A. Yes, sir.

Q. Calling your attention to Commission's Exhibit 3 in evidence, and to the forward section thereof, can you tell us whether there is any similarity between that and the Lewin rubber metatarsal crescent illustrated in your book on page 103? A. Whether there is any similarity?

Q. Yes, sir. A. Between what?

Q. Between the Lewin rubber metatarsal crescent and the device now before you? A. This goes on the bottom of a shoe?

Q. It goes on the bottom of a shoe? A. Yes.

Q. But it does have the effect of raising that area slightly, does it not? A. That is right.

Q. And what would be the effect of— A. Wait a minute. You said it has the effect of raising it?

Q. Raising that area of the foot? A. Oh, it isn't for that purpose.

Q. What is the purpose of that? A. The purpose is to transmit the weight from the heel to an area back of the metatarsal heads and relieve those heads of pressure.

Q. I see. And it does that by elevating the area back of the metatarsals, does it not? A. I don't know that it elevates it. It is a weight-bearing point, so that the person transmits his weight from the heel to an area just back of the metatarsal heads, instead of having the weight come down on the metatarsal heads.

Q. I see. A. It is sometimes called an anterior heel, that the ordinary heel that the shoe comes with is the posterior heel, and this is an anterior heel over which the foot rocks, but so far as pushing up on anything, I don't know that that occurs. I tried to do it, but when it is attached to the shoe it is just another weight-bearing point.

Q. But it does transfer weight? A. From the heel to the forefoot.

Q. Does it transfer any weight from the metatarsal heads to the points back of them? A. No, it is to relieve pressure or weight on the metatarsal heads.

Q. Then it takes weight off the metatarsal heads? A. That is right.

Q. What effect would that have on callouses of the metatarsal arch area? A. It might help, it should help them.

Q. Have you used them for that purpose, Doctor? A. Yes.

Q. That is a very frequent prescription, is it not? A. Yes.

Q. You do prescribe these things for various persons? A. Individually.

Q. Individually? A. Always.

Q. *But you send them to the shoemaker to have them executed, do you not?* A. *That is right.*

Q. Is the same true of the other devices which you depict on that page, Doctor, that you prescribe them for various patients? A. I prescribe some of them. That was an illustration of the principal ones.

Q. Yes. A. I don't know that any one person uses all of those.

Q. Surely. But they may be used in combination, too, may they not? A. Yes.

Q. Depending on the person's foot? A. That is right.

Q. And the object is to give the person relief from foot pains? A. That is one of the purposes, to give them relief from discomfort.

Q. And to aid them in balance, is it not, Doctor? A. Yes.

Q. And to perhaps improve his stance? A. Yes.

Q. Also to take weight-bearing off of sensitive parts of the feet? A. Yes.

Q. And to transfer it to other parts of the feet? A. Yes, sir."

Thus, by a comparison of the Cuboid with the devices used by Dr. Lewin, it is inescapable that, in essence, the Burns Cuboid [Pet. Ex. 1] is comprised of what Dr. Lewin describes as the "Lewin Metatarsal Crescent,"

together with side heel wedges [also as prescribed by Dr. Lewin—See Exs. 29, 30, 31, 32, 33]. It is a combination of the separate devices described by Dr. Lewin. Hence, Dr. Lewin might easily have been the inventor of the Burns Cuboid from the identical devices which he uses.

G. The Commission Itself Found From the Testimony of Their Own Witness That the Device Balances the Foot, and the Commission's Own Findings so State.

Much has been said in this case concerning the use of the word "balance" in the advertising. Foot balance has been discussed. Body balance has been discussed. And the Federal Trade Commission has ordered that the word balance and all references thereto be excised from our advertising [I R. 184].

Webster gives as synonyms of "balance," the words "equilibrium," "poise," "equipoise," and "counterpoise," when applying the word to weights, etc.

The experts in this case *all* agreed in essence that the balancing of the body is the maintenance of good equilibrium through neuro-muscular control of the muscles, bones and other structures of the body on the foot, etc.; that foot balance is the balancing of the foot upon its sole and its heel, and that body balancing is the balancing of the entire body up from the foot and includes the feet and legs [II R. 41-42, Dr. Engh; I R. 89-90, Dr. Masterson].

At II R. 222-223, Dr. Hiss described it as follows:

"A. I want to talk about locomotion before I do that. I have described stance as balancing one's weight. Walking is balancing one's weight alternately on one foot and then on the other, and there

is also weight distribution as I do that, which I will discuss later.

“Now, as I step forward, the actual part of locomotion is in the calf of the leg, that is the transverse suree, that is the big calf muscle. That is the engine which locomotes forward, so those muscles are pulling forward and pushing me off the ball of the foot as I go, but in order to keep the balance there is a muscle on either side, on the outside the peronei muscles which are in the calf of the leg, and the tibiales on the inner side. They are eternally working against each other to keep this balance. They are eternally working and they are the ones that are working on this bad foot. Really the bad foot is the one that you would have a lot of consideration, because that is the one you put the Burns cuboid on or any other kind of appliance to try to give people relief.

“That is locomotion. The engines are working in the calf of the leg in the center, and to the outside are the peronei muscles which are keeping me from going over this way, and the tibiales in the inner side of the foot keeping me from going over this way, so that they are eternally attempting to keep your balance on the outside as we walk.

“Now, that is foot function.”

Dr. Garner also defined and explained “balance” [III R. 535-538], as follows:

“Beyond the shadow of any doubt, the foot is the foundation of the body. We can have nothing as a matter of physics, no structure of any kind, without a foundation. The human body is no exception. If you are going to have it upright, you have to have a foundation.

The feet are its foundations. The body is a heavy, corporal organism, and very complicated in structure. The erect posture which man has assumed and maintains demands that he have a constant fight against gravity, because gravity is tending continuously to pull him down to the ground. That means that in some way he must be able to balance the body so that he can overcome this pull of gravity. The less the effort that is required on his part to maintain this balance, of course, the more it is to his benefit, and the more effort he has to exert to maintain it, the more detrimental to him.

Now, that being the case, the foot plays an important part, because if it tilts to one side or the other, if the arches are weak or give way and let the foot down, it changes the way and the direction in which the weight of the body is carried toward the foot.

The weight of the body, first, considering the upper body, is carried down to the large pelvic bones that we are all familiar with around the hips. From there it is carried to the large femur, the head of the upper thigh, or throughout the thigh, and down to the two bones in the leg, and then from that is transmitted to the astragalus.

The line along which that is exerted is down the front of the thigh and across the front of the knee, across the front of the leg, down across what we call the dorsum or the upper part of the foot, and would run out at a point about at the second toe, between the two toes, but closer to the second toe. That is a line that has been worked out by physicists and anatomists as being the line along which the body's weight is transmitted toward the foot.

Of course, it has to split when it strikes the os calcis to be transmitted to the ground. But if this

foot is allowed in any way to alter its normal position, whether by accident or by long continued use or weakness or whatnot, then that is going to change that line of weight bearing and change its way of transmitting toward the foot and ultimately to the ground.

Q. Will you describe the effect any disturbance of that tripod you have described will have upon the body balance? A. Well, I beg your pardon. I didn't describe the tripod. I didn't go that far.

Q. I beg your pardon. I thought you said the weight bearing was at the front and at the rear. A. No, I stopped there. I didn't know you wanted me to go that far. I spoke of the change in the weight bearing.

Q. I was thinking of the line you drew through the toes and out through the heel. A. No, I just mentioned the line that scientists have described as being the line along which weight is exerted down the front of the foot, across the middle of the leg this way, but I said nothing about the back. I better go into that.

Q. Please do. A. When the weight of the body is transmitted, largely through both the tibia and the fibula, but mostly through the tibia, when it is transmitted through the tibia here—

Q. Indicating the top of the— A. The top of the astragalus where the two meet—the bone—the weight divides. When a person, if you are standing on both feet—now, of course, the foot is not a fixed problem. We move, we walk, we dance, we climb hills, we go upstairs and come down, so it is constantly in motion, but if we are standing on both feet with the body erect in the what we call normal posture of man, one-half of the body weight would be

transmitted to each foot. That is just a question of reason, as far as that goes.

Now, when that strikes the top or articular surface of the astragalus, it goes to that bone and there divides into three special lines, one going back to the tuberosity os calcis on which the heel bone rests, another going to the base of the little toe—not the base, the head, just behind the head of the little toe—and the other one to just behind the head of the first big toe or the first metatarsal bone.

That creates a triangular way in which the weight is ultimately carried to the ground. The arch holds it up and the head of your tripod, as you might call it, would be here (indicating).

Then the three points of contact would be underneath the heel, underneath the head of the first metatarsal and underneath the head of the first and fifth metatarsals. The estimate is that half of the weight of the body—that is, half of which goes to each foot—I stated a while ago that when standing, half of the body weight is on each foot. Then, half of that goes to the os calcis. The other half is distributed between the two ends of the transverse or metatarsal arch, just behind the head of the first and fifth metatarsal bones.

The other metatarsal bones take in a certain amount of that distribution of weight, too, but they usually transmit that back more or less from one side to the other. They don't become perfectly flat. It still retains an arch across there and is transmitted, still retaining the tripod."

Dr. Lewin [IV R. 830-831] discussed "balance" as follows:

"Q. What is your opinion as to whether or not most of the body weight thrust from the tibia of

the leg is received and distributed by the inner or medial longitudinal foot bone, both in a standing position and during locomotion? A. I believe most of it is transmitted through the medial group of the bones just enumerated.

Q. In stance, that is the standing position, what is the distribution of body weight in the foot? A. I think it is variable, depending on which position the person is standing in.

Q. Will you explain to us how you arrive at that answer? A. Would you care to have me demonstrate?

Q. Yes. A. If a person stands in this position, the heels together and the toes apart, all of it is on the inner body. If he stands in a square position, straight ahead, where the heels and the toes are the same distance apart, you will note that the weight is on this side. Is that an answer to your question? However, that is variable, because no two people stand or walk alike.

Q. Where would it be distributed on the last? A. Along the inner body.

Q. With their feet out? A. That is right, and their heels together and their toes outward.

Q. Doctor, will you tell us, if you will, how much weight is borne by the first metatarsal in comparison with each of the other metatarsal bones in stance? A. Probably twice as much.

Q. Of the total weight borne by the five metatarsal bones, what proportion or percentage thereof is borne by the three medial metatarsal bones? A. I would say more than half.

Q. What part of the metatarsal bone actually bears the weight? A. The head takes the weight but there is a strain on the shaft. They meet the shoe and they meet the ground."

The device, as the Court will observe, after being worn [see Pet. Ex. 1 in Evid.; II R. 100], shapes itself to the wearer's heel. From observation of this Exhibit, it can be *seen* that on the outer edges of both sides and at the heel, there is a wedge-like elevation all the way around the sides of the heel, and the resulting surface for the heel to rest upon is concave, rather than flat. The contention of the Petitioner throughout is that, since the calcaneus is a rounded bone [Resp. Ex. 10], the wedges at the side tend to and do assist the wearer in attaining balance. During the course of the trial [II R. 49-50], counsel for the Petitioner produced a rounded glass paper weight [II R. 48-50], and balanced it on its rounded surface. Dr. Engh (for the Commission) conceded that since it was rounded, it had a tendency to roll easily. He also conceded that if a couple of rubber erasers were inserted under the edges, it did not roll so easily, and a more stable equilibrium was produced.

The same fact was volunteered by Dr. Masterson [II R. 83-84], as follows:

“Q. Now, Doctor, I will draw your attention to the elevation in this Commission Exhibit 3 here (indicating), the one beneath the cuboid bone, when pressure is put on that; do you understand that that falls into a depressed or concave pattern? A. Yes.

Q. And what effect does pressure upon the cuboid bone have— A. I wouldn't say it had any.

Q. Wouldn't you support that area slightly? A. What for?

Q. I didn't ask you what for; I said does it or does it not tend to support that area underneath the cuboid and the anterior end of the fifth metatarsal?

A. *It is practically balanced by your support on the other side.* (Emphasis ours.)

Q. The support given by the cuboid? A. No. You have got one on each side, so that they almost negate themselves.

Q. How do you mean, 'negate themselves'? A. Well, I mean if you put a one-inch lift on one side and a one-inch lift on the other side and put them together, you still have not raised them, or very little, if you are trying to elevate one side or another.

Q. I don't think you are answering my question. Doesn't it support— A. I don't feel that it does.

Q. You do not feel that it supports to the benefit of the cuboid and the fifth metatarsal? A. I don't feel that it does.

Q. What does it support? A. It doesn't support anything.

Q. It is underneath the foot? A. It is underneath the foot.

Q. And you say it does not support it? A. I don't feel it does.

Q. But the foot rests on it? A. The foot does rest on it.

Q. And if it did not support— A. But it also rests on the other lift that you have on the other side.

Q. Well, isn't that supported? A. *The two balance each other*, and I feel that they don't support." (Emphasis ours.)

At this juncture the doctor was discussing the wedges on the sides of the heel area of the Cuboid in evidence.

Whoever wrote the Commission's findings of fact did not sufficiently analyze the situation to note the inconsistency occasioned by the finding that the device does

not assist in balancing the foot [I R. 191] and by accepting Dr. Masterson's testimony above [I R. 178]. The Commission in one breath finds [I R. 178]: "The circumstance that both sides of the device are raised and there is a tendency for these lateral elevations to balance one another out," and in the next, 3 pages later [I R. 181]: "Cuboids will not assist in balancing the foot . . ." The first finding is not quite an accurate quotation or interpretation because the doctor said, "The two balance each other, and I feel that they do not support" [II R. 83-84], whereas the writer of the findings said that "There is the tendency for these lateral elevations *to balance one another out.*"

Since these side elevations do not touch each other and actually have no relation to each other except as they affect that which they both touch, namely, the human foot, therefore the only possible way they could "balance one another out" would be to balance the foot. In other words in and of themselves and with no foot resting on them, these lateral elevations could have *no balancing action whatsoever.*

So, how, indeed, can the propriety of the finding be sustained in the light of the language used, *i. e.*, when the Commission's witness and the Federal Trade Commission itself both say that these heel wedges do in fact balance the foot?

It is the same kind of balance as that effected by the two rubber wedges under the sides of the rounded glass paper weight. Balance is a stable equilibrium. The fact was so obvious that the Trial Examiner and the Commission, both lost in the maze of words, failed to see the woods for the trees!

The advertising claims concerning balance are that:

Cuboids help to balance your body weight;

They are “foot balancers”;

They afford foot balance;

They . . . “combine scientific principles of balance and support . . .”

“Now every one can enjoy better posture, poise and balance . . . with Cuboids”;

“Cuboid foot balancers . . .”

“The feet are the body’s foundation. Cuboids help balance this foundation . . .”

“Cuboid metal-free foot balancers . . .” [I R. 4-5.]

Dr. Mosiman observes [II R. 91-92]:

“Q. And is the adaptation to your foot an advantage to your foot? A. Yes, I think it is.”

And that the Cuboid adapts to the curvature of the heel [II R. 94]:

“Q. Would you say that that [Pet. Ex. I] has been adapted by wear to the foot of the wearer? A. I would say that is [it] has been adapted to the curvature of the heel.”

And [II R. 95]:

“Q. And the fact that it has been worn causes this differential in surface contour? A. I think that is a correct assumption.”

See also, II R. 97: If shoes fit, the wearer has better balance. (Dr. Masterson.)

In conclusion on this point, we submit that the truth of our advertising is so patent that even the Commission itself found:

“ . . . There is the tendency for these lateral elevations to balance one another out.” [I R. 178.]

That is what we mean by balance—a surface on which the foot walks, which is molded to the foot, has side elevations, which support both sides of the foot, *i. e.*, a more stable equilibrium caused by the contour of the cuboid when walked on.

H. Applicable Law.

(i) The False Advertising.

The law upon the subject of false advertising seems well settled:

The purpose of the law is for the protection of the public against the obvious evils which attend upon falsity in advertising of medicines or devices. An able exposition is found in the case of *Charles of the Ritz v. Federal Trade Commission*, 143 F. 2d 676:

“The law was not ‘made for the protection of experts, but for the public—that vast multitude which includes the ignorant, the unthinking and the credulous’ *Florence Mfg. Co. v. J. C. Dowd & Co.*, 178 F. 73, 75, and the ‘fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced.’ *F. T. C. v. Standard Education Soc.*, 302 U. S. 112, 116, 58 S. Ct. 113, 115, 82 L. Ed. 141. See also, *Stanley Laboratories, Inc. v. F. T. C.* (9 Cir.), 138 F. 2d 388, 392, 393; *Aronberg v. F. T. C.* (7 Cir.), 132 F. 2d 165, 167; *D. D. D. Corp. v. F. T. C.* (7 Cir.), 125 F. 2d

679, 682. The important criterion is the net impression which the advertisement is likely to make upon the general public." (Citing cases.)

In *Moretrench Corp. v. Federal Trade Commission*, 127 F. 2d 792, 795, the court says that the Commission may "insist upon the most literal truthfulness" on the part of the advertiser.

The case of *General Motors Corp. v. Federal Trade Commission*, 114 F. 2d 33, 36; cert. den. 312 U. S. 682, 61 S. Ct. 550, 85 L. Ed. 1120, ascends to the realm of Biblical dissertation and quotation and asserts as a matter of law that the Federal Trade Commission

"has the discretion to insist if it chooses 'upon a form of advertising clear enough so that in the words of the Prophet Isiah, "wayfaring men, though fools, shall not err therein."'"

In the case of *Aronberg v. Federal Trade Commission*, 132 F. 2d 165 (7 Cir.), it is held that the advertising therein contained was properly determined by the Commission to be false because of a definite innuendo which was therein contained. In discussing the matter, the court stated as follows (pp. 169-170):

"Physicians, experts in gynecology and obstetrics, testified as to the qualities and effects of the preparation. They generally agreed that taking them in small quantities or for a short period would probably not cause a serious result, although the patient might experience discomfort. However, their evidence is that if the medicines are taken for a period of from four to ten days as prescribed, danger of a severe abnormal circulatory condition due to constriction of blood vessels will arise, resulting in severe gastro-intestinal disturbances and violent poisonous effects up-

on the human organic system. In some instances, where women particularly are susceptible to or are suffering from certain diseases, such results will appear more quickly and will be fraught with greater danger. In pregnancy, harmful results will be more probable and, when occurring, were pronounced. Use of such preparations may cause abortion. An overdose of from six to twelve pills in a day may produce dangerous results within a day or two, while taking the pills as prescribed for a period of from two to three weeks is likely not only to produce the mentioned dangerous results, but also to lead to a gangrenous condition of serious nature. The consensus of the expert testimony was that petitioner's preparations are not competent, safe, or reliable as a relief for delayed menstruation because of the heavy dosage of drugs contained in each capsule. There was also substantial agreement among all the medical witnesses that in sound medical practice, doctors will prescribe emmenagogues only in exceptional cases, and then only after careful examination of the patient and under strict instruction and supervision.

"It is thus apparent that the Commission was justified in believing that where preparations such as petitioner's are sold indiscriminately to the public and taken without medical supervision, prescription or adequate warning as to probable effect, many users, because of ignorance, alarm or desire for quick relief, are likely to take excessive or too frequent doses, thus increasing the dangerous potentialities. Yet there is nothing to warn users against such contingencies. In fact, statements that the preparations are 'harmless,' 'non-habit forming,' 'pure vegetable ingredients' quite reasonably lead users to believe that not only are the capsules absolutely safe to use as suggested but safe to use in excess."

Certainly no such effects as are there described could, from all the evidence, even be remotely expected from any usage of Burns Cuboids, the device in question. It is not an internal device; it merely goes under the sole of the purchasers' foot inside his shoes. If he is dissatisfied, his feet will soon tell him, and he can take them back to the point of purchase and get his money back. The device is definitely not in that class of devices where there is any drug, or chemical compound, taken into the internal system of the purchaser.

In addition, it is definitely not such a device as can be said to have any inherent danger in it whatsoever if not "taken" under the auspices of a physician. The entire record contains not even a hint to the contrary. The device is analogous to a crutch, not an arthodontic brace. The Commission should, of course, exercise the greatest of vigilance over the advertising of those therapeutic devices which contain inherent danger to the purchaser.

Here self medication is concerned. If I sprain my ankle, it does not take a doctor to tell me that I need a crutch. If there is an inherent sprain in my foot, and if by trying Burns Cuboids I gain relief, there is no need for a doctor to tell me to wear them. If, on the other hand, I do not gain relief, neither then do I need a doctor to tell me to take the device out of my shoe and go and get my money back.

It is in no sense in that category of devices which were the subject of investigation and discussion in connection with advertising in the case of *Irwin v. Federal Trade Commission*, 143 F. 2d 316.

The device therein discussed was entitled a "detoxifier," which we have discussed above.

There the Commission, we quite concur, was more than fully justified in taking action to stop such advertising. The court, in summing up the reasons for its sustaining the Order of the Commission, states as follows:

“The existence of a public interest here rests on the deception practiced upon the public.” (Citing *Federal Trade Commission v. Royal Milling Co.*, 288 U. S. 212, 53 S. Ct. 335, 77 L. Ed. 706, and *National Silver Co. v. F. T. C.* (2 Cir.), 88 F. 2d 425.)

It is selected by us as an example of what we point to as false advertising. We are not here trying the “detoxifier,” but we wish to emphasize the distinction between that class of advertising and the advertising which is in evidence in the stipulation in this case as being in current use by the Petitioner.

No such quackery can be charged to our door. A similar situation involving the general policy of the United States, although not involving the Federal Trade Commission, is found in *United States v. 62 Packages of Marmola Prescription Tablets, Raladam Co., Intervenor*, 48 Fed. Supp. 878.

The article there involved was “Marmola Tablets” which contained, among other things, *dessicated thyroid*, a powerful drug. False and misleading labelling was charged. Marmola was advertised as being effective in reducing weight and contained quite an extensive set of directions for self medication in the labelling and pamphlets which went with the product. The court stated as follows (p. 887):

“The Federal Food, Drug and Cosmetic Act was not made for experts, nor is it intended to prevent self-medication. The purpose of the law is to protect

the public, the vast multitude which includes the ignorant, the unthinking, and the credulous who, when making a purchase, do not stop to analyze. It was enacted to make *self-medication safer and more effective*, and to require that drugs moving in interstate commerce be properly labeled so that their use as prescribed *may not be dangerous to the health of the user*. It should receive a liberal construction. *United States v. Lee* (7 Cir.), 131 F. 2d 464; *Flourance Mfg. Co. v. J. C. Dowd & Co.* (2 Cir.), 178 F. 73; *Aronberg v. Federal Trade Commission* (7 Cir.), 132 F. 2d 165. (Italics ours.)

“The administration of thyroid tablets in Marmola dosages is a dangerous procedure, and should not be undertaken without a thorough examination of the prospective user by a competent physician, and then only under the supervision of the doctor.

“The Court is thoroughly convinced, by a preponderance of the evidence that Marmola when used as prescribed in the labeling thereof, is neither a safe, appropriate, nor an efficient remedy for obesity; that it is dangerous to the health of the user when used in the dosage or with the frequency and duration prescribed, recommended or suggested in the labeling thereof; that the packages of Marmola in question, when seized in these proceedings, were misbranded within the meaning of the sections of the Federal Food, Drug and Cosmetic Act involved herein; that the labeling on Marmola is false and misleading in its representations that it is a safe remedy for obesity, and in that it fails to reveal facts material with respect to consequences which may result from the use of Marmola under the conditions prescribed in the labeling.”

Our product in the first place, contains absolutely no danger whatsoever to the public, no matter what advertising accompanies it, so long as the obvious occurs and the purchaser puts it in his shoe. If by any chance the purchaser should be suffering from some systemic disease which conceivably might affect the bones of his feet, the insertion of a Burns Cuboid in his shoe *can in no wise affect that* disease. The Commission, having the burden of proof, has failed absolutely (although it tried), to prove that if some purchaser were suffering from a systemic disease, he might conceivably suffer from evil consequences from the device.

Our device could do no possible harm.

In *Federal Trade Commission v. Standard Education Society*, 302 U. S. 112, 116, 58 S. Ct. 113, 115, 82 L. Ed. 141, the court said:

“The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced. There is no duty resting upon a citizen to suspect the honesty of those with whom he transacts business. Laws are made to protect the trusting as well as the suspicious. The best element of business has long since decided that honesty should govern competitive enterprises, and that the rule of *caveat emptor* should not be relied upon to reward fraud and deception.

“* * * To fail to prohibit such evil practices would be to elevate deception in business and give to it the standing and dignity of truth.”

Thus we see that the question is not what effect the advertising will have upon the experts but upon the gen-

eral public as a whole and even as it is said in *Florence Mfg. Co. v. J. C. Dowd & Co.* (2 Cir.), 178 Fed. 73 at 75:

“The law is not made for the protection of experts but for the public—that vast multitude which includes the ignorant, the unthinking and the credulous who, in making purchases, do not stop to analyze but are governed by appearance and general impressions.”

See also:

Stanley Laboratories v. Federal Trade Commission (9 Cir.), 138 Fed. 388;

D. D. D. Corp. v. Federal Trade Commission (7 Cir.), 125 F. 2d 679;

Dorfman v. Federal Trade Commission (8 Cir.), 144 F. 2d 739;

A. P. W. Paper Co. v. Federal Trade Commission (2 Cir.), 149 F. 2d 424, aff'd 328 U. S. 193, 66 S. Ct. 932, 90 L. Ed. 1165;

Gulf Oil Corp. v. Federal Trade Commission (5 Cir.), 150 F. 2d 106;

Parker Pen Co. v. Federal Trade Commission (7 Cir.), 159 F. 2d 509;

Stork Restaurant v. Sahati (9 Cir.), 166 F. 2d 348.

A recent statement on this point is contained in *P. Lorillard Co. v. Federal Trade Commission*, 186 F. 2d 52 at 58, as follows:

“In determining whether or not advertising is false or misleading within the meaning of the statute, regard must be had, not to fine spun distinctions and argument that may be made in excuse, but to the effect which it might reasonably be expected to have upon the general public. The important criterion is the net impression which the advertisement is likely

to make upon the general populace.' *Charles of the Ritz Dist. Corp. v. Federal Trade Comm.*, 2 Cir., 143 F. 2d 676, 679-680. As was well said by Judge Coxe in *Florence Manufacturing Co. v. J. C. Dowd & Co.*, 2 Cir., 178 F. 73, 75, with reference to the law relating to trademarks:

“‘The law is not made for the protection of experts, but for the public—that vast multitude which includes the ignorant, the unthinking and the credulous who in making purchases, do not stop to analyze, but are governed by appearances and general impressions.’ See also *Federal Trade Comm. v. Standard Education Soc.*, 302 U. S. 112, 58 S. Ct. 113, 82 L. Ed. 141; *Stanley Laboratories v. F. T. C.*, 9 Cir., 138 F. 2d 388; *Aronberg v. F. T. C.*, 7 Cir., 132 F. 2d 165; *Ford Motor Co. v. F. T. C.*, 6 Cir., 120 F. 2d 175.”

What, then, is the effect of the word “balance” upon the mind of the general public? Also foot balance; body balance?

The technical explanations from the experts in this case concerning the meaning of foot and body balance, while very interesting, while educational, and while serving basically to give an understanding, a concept of foot balance, are all of very little aid if they differ in meaning and context from the impression which the advertising involved makes upon the public.

Just what is the impression upon the public mind of the following advertising claims?

“Cuboids help to balance your body weight.”

The device is named after the Cuboid bone, but to the ordinary lay reader, the word “Cuboid” contains no connotative meaning whatsoever with reference to the human

foot or its parts. Thus, the lay reader, upon reading the foregoing, will be led to associate the word "Cuboid" with the shoe insert, and he will next be led to the idea, the concept, that this device helps to balance his body weight. He can see that it is a device to be fitted into a shoe. He knows instinctively that he walks upon his feet and he immediately gets the idea that the device is intended to help him balance himself as he walks or stands upon his feet, and that the claim is that the device will do so.

He (being one of those utterly ignorant members of the public mentioned by the courts) has no concept of the nervous tension or the concatenation of neuro-muscular forces necessary to accomplish balance, and thus receives the mere and simple impression that Cuboids help him to balance his body on his feet.

The connotative meaning induced, the impression upon the lay public, the meaning—under the cases—of the advertising, thus, is that the product will help to balance body weight on the foot—in the lay sense. That lay sense means, in essence, that it makes walking and standing easier and more comfortable for the purchaser to accomplish; also that it lessens fatigue to wear Cuboids and thereby posture and poise are improved; too, that the side heel wedges "balance each other out."

(ii) Secondary Meaning.

The word "Cuboid" is here a trade name. It has acquired [or is acquiring] a secondary meaning. Secondary meaning is discussed in the *Elgin Watch* case, 179 U. S. 665, 45 L. Ed. 365, 21 S. Ct. 270. Here it is of a shoe insert designed to give comfort by assisting in the balance of the wearer's feet and body.

The lay reader has come or is coming to recognize the word "Cuboid" in this connection and not with any reference to the technical "orthopedic" effect of the device upon the cuboid bone.

All of our advertisements, we submit, tend to produce in the lay mind the idea that Cuboids aid foot comfort and that they help the wearer balance himself on his feet—simply that and nothing more. Actually, the Commission *did so find!*

(iii) The Commission Cannot Interpolate.

The case of *International Parts Corp. v. Federal Trade Commission*, 133 F. 2d 883, holds that the Federal Trade Commission cannot

"interpolate into the petitioner's representations words not there and then find the petitioner guilty of misrepresentation because the petitioner's product does not meet the Commission's revised representations."

That is exactly what it has tried to do here—interpolate much into the advertising that is not there, and then find us guilty of untruth as to the interpolated meaning.

This, we submit, the Commission cannot do; and these advertising claims cannot be so interpreted as to say more than they do say without such interpolation.

(iv) Too Short a Rein.

The Honorable Learned Hand, while on the Bench, was one of the greatest jurists who has ever graced the American scene. In the case of *Federal Trade Commission v. Standard Educational Society*, 86 F. 2d 692 at 696, Judge Hand brings to the field which we are dis-

cussing the following concept as to the powers and duties of the Federal Trade Commission:

“ . . . its duty is to bring trade into harmony with fair dealing. *F. T. C. v. Winsted Hosiery Co.*, 258 U. S. 483, 493-494, 42 S. Ct. 384, 385, 386, 66 L. Ed. 729. To the discharge of that duty it should not, however, bring a pedantic scrupulosity. Too solicitous a censorship is worse than any evils it may correct, and a community which sells for profit must not be ridden on so short a rein that it can only move at a walk.”

From all the evidence we sincerely urge that it must be concluded that our claims all have sound medical background, and each is vouched for in theory and practice by responsible, top-flight members of the medical profession, and even the Commission found that our device balances the foot. Thus, the hair-line distinctions of the Commission are far “too short a rein.”

Aiding “strained, tired feet”—the Commission’s admission [I R. 180] and having “no therapeutic value in the treatment of aching or painful feet” [I R. 180] are categorical denials of each other. We are left where we cannot tell what the law is—even the “law of the case.” Even though the Commission’s distinctions were clear and definitive [which they are NOT], we still would urge that it is “too short a rein” under all the facts of this case.

(v) No Fair Trial.

We have analyzed the evidence, the rulings of the Trial Examiner, and his attitude in general, in the earlier portions of this brief. We respectfully cite the brief of petitioner filed in this Court in the case of *Carter Products, Inc., a corporation, Petitioner v. Federal Trade Commis-*

sion, on July 14, 1952, and quote from pages 14 and 15 thereof, as follows:

“Petitioner earnestly asserts that when a government agency arrogates to itself in this fashion the functions of an arbiter of scientific and medical opinion, it behooves that agency to prove—as it has not done here—by the clearest and most convincing evidence, that the views of those in disagreement with it are unquestionably false. This is particularly true where, as here, those views are supported by a large body of respectable scientific opinion. Surely, before exercising so vast a power of censorship, condemnation and destruction of property rights, such a body, acting as complainant, prosecutor, judge and jury, should be held in the conduct of its hearings to the highest standards of fairness, impartiality and latitude in permitting cross-examination of the witnesses whom it proffers as the expert mouth-pieces of its views.

“ ‘Regulatory commissions have been invested with broad powers within the sphere of duty assigned to them by law. * * * All the more insistent is the need, when power has been bestowed so freely, that the “inexorable safeguard” (St. Joseph Stock Yards Co. v. United States, 298 U. S. 38, 73) of a fair and open hearing be maintained in its integrity. Morgan v. United States, 298 U. S. 468, 480, 481; Interstate Commerce Comm’n v. Louisville & N. R. Co., *supra*. The right to such a hearing is one of “the rudiments of fair play” (Chicago, M. & St. P. Ry. Co. v. Polt, 232 U. S. 165, 168) assured to every litigant by the Fourteenth Amendment as a minimal requirement.’ ”

Brinkheroff-Faris Co. v. Hill, 281 U. S. 673, 682.

If there was no fair hearing, the Court should not be disposed to speculate as to what would have been the outcome, had a fair and impartial hearing been accorded.

Inland Steel Co. v. N. L. R. B. (7 Cir.), 109 F. 2d 9;

Empire Oil & Gas Co. v. United States (9 Cir.), 136 F. 2d 868, 871;

Willapoint Oysters v. Ewing (9 Cir.), 174 F. 2d 676, cert. den. 338 U. S. 860, 70 S. Ct. 101, 94 L. Ed. 527;

Reilly v. Pinkus, 338 U. S. 269, 70 S. Ct. 110, 94 L. Ed. 63.

(vi) The Question Is of Substantial Evidence.

The case of *Universal Camera Corp. v. National Labor Relations Board*, 340 U. S. 474, 71 S. Ct. 456, 95 L. Ed. 456, is a landmark case in administrative law in the annals of American Jurisprudence. Prior to the pronouncement of that decision by the Supreme Court, the appellate courts largely had left the finding of the facts *entirely* to the administrative agencies.

The case is of such magnitude and importance that we here reproduce what we deem to be the germane portions of the Supreme Court's decision:

"Want of certainty in judicial review of Labor Board decisions partly reflects the intractability of any formula to furnish definiteness of content for all the impalpable factors involved in judicial review. But in part doubts as to the nature of the reviewing power and uncertainties in its application derive from history, and to that extent an elucidation of this history may clear them away.

“The Wagner Act provided: ‘The findings of the Board as to the facts, if supported by evidence, shall be conclusive.’ Act of July 5, 1935, §10(e), 49 Stat. 449, 454, 29 U. S. C., §160(e). This Court read ‘evidence’ to mean ‘substantial evidence.’ *Washington, V. & M. Coach Co. v. Labor Board*, 301 U. S. 142, and we said that ‘[s]ubstantial evidence is more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.’ *Consolidated Edison Co. v. Labor Board*, 305 U. S. 197, 229. Accordingly it ‘must do more than create a suspicion of the existence of the fact to be established. . . . it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury.’ *Labor Board v. Columbian Enameling & Stamping Co.*, 306 U. S. 292, 300.

“The very smoothness of the ‘substantial evidence’ formula as the standard for reviewing the evidentiary validity of the Board’s findings established its currency. But the inevitably variant applications of the standard to conflicting evidence soon brought contrariety of views and in due course bred criticism. Even though the whole record may have been canvassed in order to determine whether the evidentiary foundation of a determination by the Board was ‘substantial,’ the phrasing of this Court’s process of review readily lent itself to the motion that it was enough that the evidence supporting the Board’s result was ‘substantial’ when considered by itself. It is fair to say that by imperceptible steps regard for the fact-finding function of the Board led to the assumption that the requirements of the Wagner Act were met when the reviewing court could find in the record evidence which, when viewed in isolation, substantiated the Board’s findings. Compare

Labor Board v. Waterman Steamship Corp., 309 U. S. 206; *Labor Board v. Bradford Eyeing Assn.*, 310 U. S. 318; and see *Labor Board v. Nevada Consolidated Copper Corp.*, 316 U. S. 105. This is not to say that every member of this Court was consciously guided by this view or that the Court ever explicitly avowed this practice as doctrine. What matters is that the belief justifiably arose that the Court had so construed the obligation to review.

“Criticism of so contracted a reviewing power reinforced dissatisfaction felt in various quarters with the Board’s administration of the Wagner Act in the years preceding the war. The scheme of the Act was attacked as an inherently unfair fusion of the functions of prosecutor and judge. Accusations of partisan bias were not wanting. The ‘irresponsible admission and weighing of hearsay, opinion, and emotional speculation in place of factual evidence’ was said to be a ‘serious menace.’ No doubt some, perhaps even much, of the criticism was baseless and some surely was reckless. What is here relevant, however, is the climate of opinion thereby generated and its effect on Congress. Protests against ‘shocking injustices’ and intimations of judicial ‘abdication’ with which some courts granted enforcement of the Board’s orders stimulated pressures for legislative relief from alleged administrative excesses.

“The strength of these pressures was reflected in the passage in 1940 of the Walter-Logan Bill. It was vetoed by President Roosevelt, partly because it imposed unduly rigid limitations on the administrative process, and partly because of the investigation into the actual operation of the administrative process then being conducted by an experienced committee appointed by the Attorney General. It is worth noting that despite its aim to tighten control

over administrative determinations of fact, the Walter-Logan Bill contented itself with the conventional formula that an agency's decision could be set aside if 'the findings of fact are not supported by substantial evidence.'

"The final report of the Attorney General's Committee was submitted in January, 1951. The majority concluded that '[d]issatisfaction with the existing standards as to the scope of judicial review derives largely from dissatisfaction with the fact finding procedures now employed by the administrative bodies.' Departure from the 'substantial evidence' test, it thought, would either create unnecessary uncertainty or transfer to courts the responsibility for ascertaining and assaying matters the significance of which lies outside judicial competence. Accordingly, it recommended against legislation embodying a general scheme of judicial review.

"Three members of the Committee registered a dissent. Their view was that the 'present system or lack of system of judicial review' led to inconsistency and uncertainty. They reported that under a 'prevalent' interpretation of the 'substantial evidence' rule 'if what is called "substantial evidence" is found anywhere in the record to support conclusions of fact, the courts are said to be obliged to sustain the decision without reference to how heavily the countervailing evidence may preponderate—unless indeed the stage of arbitrary decision is reached. Under this interpretation, the courts need to read only one side of the case and, if they find any evidence there, the administrative action is to be sustained and the record to the contrary is to be ignored.' Their view led them to recommend that Congress enact principles of review applicable to all agencies not excepted by unique characteristics. One of these

principles was expressed by the formula that judicial review could extend to 'findings, inferences, or conclusions of fact unsupported, upon the whole record, by substantial evidence.' So far as the history of this movement for enlarged review reveals, the phrase 'upon the whole record' makes its first appearance in this recommendation of the minority of the Attorney General's Committee. This evidence of the close relationship between the phrase and the criticism out of which it arose is important, for the substance of this formula for judicial review found its way into the statute books when Congress with unquestioning—we might even say uncritical—unanimity enacted the Administrative Procedure Act.

"One is tempted to say 'uncritical' because the legislative history of that Act hardly speaks with that clarity of purpose which Congress supposedly furnishes courts in order to enable them to enforce its true will. On the one hand, the sponsors of the legislation indicated that they were reaffirming the prevailing 'substantial evidence' test. But with equal clarity they expressed disapproval of the manner in which the courts were applying their own standard. The committee reports of both houses refer to the practice of agencies to rely upon 'suspicion, surmise, implications, or plainly incredible evidence,' and indicate that courts are to exact higher standards 'in the exercise of their independent judgment' and on consideration of 'the whole record.'

"Similar dissatisfaction with too restricted application of the 'substantial evidence' test is reflected in the legislative history of the Taft-Hartley Act. The bill as reported to the House provided that the 'findings of the Board as to the facts shall be conclusive unless it is made to appear to the satisfaction of the court either (1) that the findings of fact are

against the manifest weight of the evidence, or (2) that the findings of fact are not supported by substantial evidence.' The bill left the House with this provision. Early committee prints in the Senate provided for review by 'weight of the evidence' or 'clearly erroneous' standards. But, as the Senate Committee Report relates, 'it was finally decided to conform the statute to the corresponding section of the Administrative Procedure Act where the substantial evidence test prevails. In order to clarify any ambiguity in that statute, however, the committee inserted the words "questions of fact, if supported by substantial evidence *on the record considered as a whole*. . . ."'

"This phraseology was adopted by the Senate. The House conferees agreed. They reported to the House: 'It is believed that the provisions of the conference agreement relating to the courts' reviewing power will be adequate to preclude such decisions as those in *N. L. R. B. v. Nevada Consol. Copper Corp.* (316 U. S. 105) and in the *Wilson, Columbia Products, Union Pacific Stages, Hearst, Republic Aviation*, and *Le Tourneau, etc.*, cases, *supra*, without unduly burdening the courts.' The Senate version became the law.

"It is fair to say that in all this Congress expressed a mood. And it expressed its mood not merely by oratory but by legislation. As legislation that mood must be respected even though it can only serve as a standard for judgment and not as a body of rigid rules assuring sameness of application. Enforcement of such broad standards implies subtlety of mind and solidity of judgment. But it is not for us to question that Congress may assume such qualities in the federal judiciary.

“From the legislative story we have summarized, two concrete conclusions do emerge. One is the identity of aim of the Administrative Procedure Act and the Taft-Hartley Act regarding the proof with which the Labor Board must support a decision. The other is that now Congress has left no room for doubt as to the kind of scrutiny which a Court of Appeals must give the record before the Board to satisfy itself that the Board’s order rests on adequate proof.

“It would be mischievous word-playing to find that the scope of review under the Taft-Hartley Act is any different from that under the Administrative Procedure Act. The Senate Committee which reported the review clause of the Taft-Hartley Act expressly indicated that the two standards were to conform in this regard, and the wording of the two Acts is for purposes of judicial administration identical. And so we hold that the standard of proof specifically required of the Labor Board by the Taft-Hartley Act is the same as that to be exacted by courts reviewing every administrative action subject to the Administrative Procedure Act.

“Whether or not it was ever permissible for courts to determine the substantiality of evidence supporting a Labor Board decision merely on the basis of evidence which in and of itself justified it, without taking into account contradictory evidence or evidence from which conflicting inferences could be drawn, the new legislation definitively precludes such a theory of review and bars its practice. The substantiality of evidence must take into account whatever in the record fairly detracts from its weight. This is clearly the significance of the requirement in both statutes that courts consider the whole record. Committee reports and the adoption in the Adminis-

trative Procedure Act of the minority views of the Attorney General's Committee demonstrate that to enjoin such a duty on the reviewing court was one of the important purposes of the movement which eventuated in that enactment."

This has been commented upon very succinctly in *Securities and Exchange Commission v. Cogan* (9th Cir., 1951), 201 F. 2d 78, in a decision which, in part, reads as follows:

" . . . In *Universal Camera Corp. v. Labor Board*, 340 U. S. 474, 71 S. Ct. 456, 95 L. Ed. 456, the Supreme Court had occasion to discuss at length the extensive criticisms of what Congress and the members of the bar had come to regard as too contracted a reviewing power in the courts with respect to administrative orders. The court noted the reports of various committees expressing dissatisfaction with the existing standards as to the scope of judicial review and after reference to the committee reports concluded that by the adoption of the Administrative Procedure Act (as well as by the adoption of the Taft-Hartley Act, 29 U. S. C. A., §141 *et seq.*, which was there involved), Congress had 'expressed a mood' that in the future courts must assume more responsibility for review of administrative orders than they had in the past. Of course the *Universal Camera* case was dealing with the problem of an enlarged review of fact determinations. But we would blind ourselves to reality if we did not recognize that the extensive criticisms of the courts which led to the adoption of the Administrative Procedure Act were not limited to the courts' failure to function merely in cases involving fact determination.

“In enacting the Administrative Procedure Act, Congress did not merely express a mood that questions of law are for the courts rather than agencies to decide,—it so enacted with explicit phraseology. Section 10 provides: ‘Except so far as (1) statutes preclude judicial review, or (2) agency action is by law committed to agency discretion—[neither of these exceptions applies here] * * * (e) Scope of review. So far as necessary to decision and where presented *the reviewing court shall decide all relevant questions of law*, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, *or otherwise not in accordance with law* * * *.’ (Emphasis supplied.) As the Congressional committees stated in reporting the bill: ‘This subsection provides that questions of law are for courts rather than agencies to decide in the last analysis and it also lists the several categories of questions of law.’ Surely this Act gives no warrant for any strained extension of the doctrine of the second *Chenery* case to the facts here.”

We present these as indicative of a trend.

Under the doctrine of the *Universal Camera Corporation* case, and some other cases following it, notably:

National Labor Relations Board v. Associated Drygoods, 209 F. 2d 593;

Motion Picture Ad Service v. Federal Trade Commission, 194 F. 2d 633;

Carter Products v. Federal Trade Commission (9th Cir.), 201 F. 2d 446,

we believe the trend is that the reviewing courts may and will look critically at the evidence adduced before the Commission to determine whether or not there is substantial evidence to support the findings of the Commission.

This, as contradistinguished from the old scintilla rule, as shown by the *Universal Camera* case.

Not applicable here because the statute (F. T. C. Act), provides otherwise, but very illustrative of this trend, is the new proposed amendment to Rule 452 of the Rules of Civil Procedure for United States District Court as prepared by the Advisory Committee on Rules for Civil Procedure. While it is not the law unless passed, it is, we believe, germane to quote the new proposal (p. 45):

“Findings of fact shall not be set aside unless clearly erroneous. In the application of this principle, regard shall be given to the special opportunity of the trial court to judge the credibility of those witnesses who appeared personally before it.”

The comment of the Committee sets forth that the amendment is designed to correct a judicial glossing over upon the rule which had tended to distort it. The Committee states:

“The stated test that findings of fact shall not be set aside ‘unless clearly erroneous’ obviously grants a considerable discretion to the trial or reviewing court . . .

“The Supreme Court in applying this rule has said, ‘A finding is clearly erroneous when, *although there is evidence to support it*, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.’ ”
(Italics ours.)

See:

United States v. United States Gypsum Co., 333 U. S. 364, 395;

United States v. Yellow Cab Co., 338 U. S. 338;

United States v. Oregon State Medical Society, 343 U. S. 326;

Dalehite v. United States, 346 U. S. 15, 24, 42, 54;

Gindorff v. Prince (2d Cir.), 189 F. 2d 897.

See also:

Smyth v. Barneson (9th Cir.), 181 F. 2d 143, 144.

See also:

Scope of Appellate Fact Review Widened, 2 Stan. L. Rev. 784.

It is particularly interesting to observe in this connection that as a matter of practical effect, the Court here is in exactly the same position to weigh the evidence, as was the Commission. In many cases with respect to review of decisions of courts, as distinguished from administrative agencies, it has of late been held (in keeping with and as part of the trend which we believe we delineate), that where the testimony before the trial court was by deposition or the evidence was entirely documentary, the reviewing court is in as good a position as was the trial judge to evaluate it. Cases on this point are:

Fleming v. Palmer (1st Cir.), 123 F. 2d 749, cert. den. 316 U. S. 662;

Banister v. Solomon (2d Cir.), 126 F. 2d 740;

Ball v. Paramount Pictures, Inc. (3d Cir.), 169 F. 2d 317;

Penn. etc. v. Crapet (5 Cir.), 199 F. 2d 850;

Himmel Bros. Co. v. Serrick Corp. (7th Cir), 122 F. 2d 740;

State Farm Mutual Auto Ins. Co. v. Bonacci (8th Cir.), 111 F. 2d 412;

Smyth v. Barneson (9th Cir.), 181 F. 2d 143.

So at this time there should be no doubt we submit, of the powers of the Court with respect to administrative rulings.

IX.

CONCLUSION.

It is respectfully submitted in conclusion: that this Court has jurisdiction; that the specifications of error are well taken; that there was no fair trial; that Petitioner's advertising claims are true; that the findings of the Commission are not supported by substantial evidence; and that, therefore, the Order of the Commission should be set aside.

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No. 14354

**In the United States Court of Appeals
for the Ninth Circuit**

JAMES H. SEWELL, DOING BUSINESS UNDER THE FICTITIOUS
FIRM NAME AND STYLE OF BURNS CUBOID COMPANY, PETI-
TIONER

v.

FEDERAL TRADE COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER TO CEASE AND DESIST

BRIEF FOR RESPONDENT

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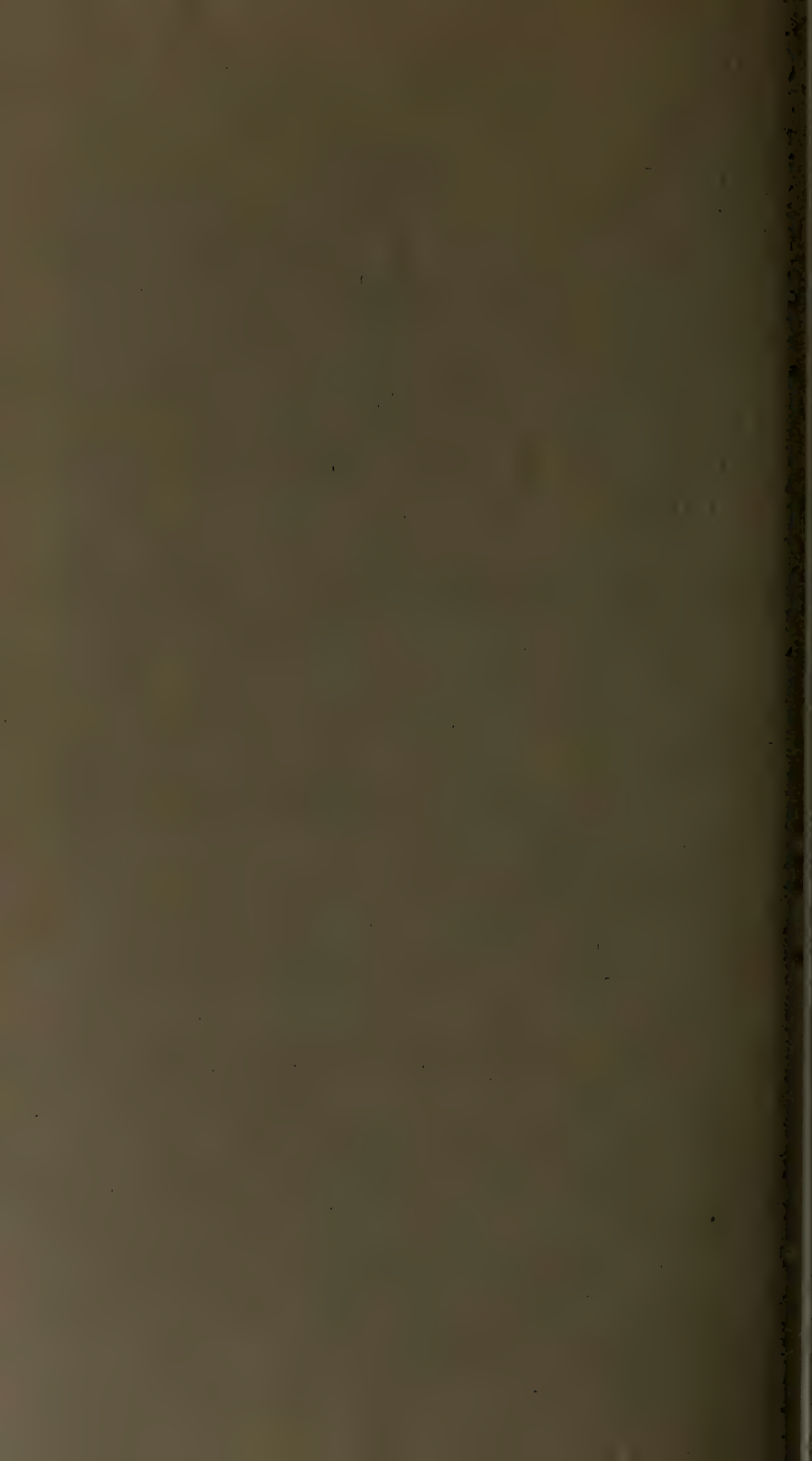
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In the United States Court of Appeals for the Ninth Circuit

No. 14354

JAMES H. SEWELL, DOING BUSINESS UNDER THE FICTITIOUS
FIRM NAME AND STYLE OF BURNS CUBOID COMPANY, PETI-
TIONER

v.

FEDERAL TRADE COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER TO CEASE AND DESIST

BRIEF FOR RESPONDENT

I. STATEMENT OF THE CASE

This case is before the Court on a petition for review and to set aside an order to cease and desist (I. R. 183-186), issued by the Federal Trade Commission, respondent, pursuant to a complaint charging petitioner¹ with engaging in unfair and deceptive acts and practices in interstate commerce in violation of the Federal Trade Commission Act.²

The proceeding below conforms to all the requirements of, and was in full and complete compliance with, the applicable provisions of the Federal Trade Commission Act, the Adminis-

¹The complaint was issued against James H. Sewell and George Pepperdine, copartners trading as Burns Cuboid Company. During the course of the hearings, it developed that Sewell had purchased the interest of his partner. However, the order was issued against both respondents below and has now become final as to George Pepperdine. Sewell is the only petitioner before this Court, and in the interest of simplicity this brief is written as though petitioner was the only party respondent below.

²The pertinent provisions of the Act are set forth, *post*, pp. 25-26.

trative Procedure Act, and the applicable rules of the Commission's Rules of Practice then in effect.

The complaint, briefly summarized (I. R. 2-11), alleged that petitioner, trading as Burns Cuboid Company, was engaged in the sale and distribution in interstate commerce of a device, as "device" is defined in the Federal Trade Commission Act, generally designated "Cuboids," "Burns Cuboids," or "Cuboids Foot Balancer," and sometimes referred to as "Doggies"; that to induce the purchase of his said device petitioner disseminated and caused to be disseminated, by means of the United States mails and in interstate commerce by various other means, false advertisements purporting to be descriptive of the therapeutic and orthopedic value of his device. The representations made in these advertisements were set out in the complaint (Par. 3, complaint; I. R. 4-5). The complaint charged that such representations were misleading in material respects and constituted "false advertisements" as defined in the Federal Trade Commission Act (52 Stat. 116; 15 U. S. C. 55).

The complaint then alleged that the use by petitioner of the false statements and representations "has the tendency and capacity to mislead and deceive a substantial portion of the purchasing public into the erroneous belief that such representations are true, thereby inducing the purchase of the said devices," and concluded that by these acts and practices petitioner had violated the Federal Trade Commission Act.

In his answer petitioner admitted being engaged in selling in interstate commerce the device described in the complaint and the dissemination of the advertisements as alleged in the complaint. He pleaded, however, that certain of those advertisements had been discontinued and denied all other material allegations of the complaint.

After issue was thus joined, the Commission duly designated one of its hearing examiners to hold hearings. Upon the completion of the hearings the examiner filed his initial decision with the Commission containing his findings as to the facts, conclusions, and order to cease and desist. Thereafter petitioner timely filed his notice of appeal from the initial decision of the hearing examiner.

On the 12th day of March 1954, the Commission made two separate but related decisions: (1) an order denying petitioner's appeal (I. R. 150-169); and (2) the decision of the Commission containing findings as to the facts, conclusions, and order to cease and desist (I. R. 170-186).

Except insofar as petitioner contends that the findings relating to falsity of his representations are not based upon substantial evidence, there is no dispute as to the facts. We shall therefore summarize the pertinent facts, with annotations to the record, that form the basis of the Commission's findings and conclusions and which support the order to cease and desist.

The Commission found that petitioner had disseminated since 1947 and is now disseminating, by the United States mails and by various other means in interstate commerce, advertisements containing the representations set forth in the complaint.³

The Commission found that through the use of those statements and representations petitioner has represented "directly and by implication, that the use of [his] device will assist the wearer to obtain body balance and foot balance; that it will relieve aches and pains regardless of the cause thereof; that more normal foot action will result from the use of said device; that [his] device will assure the user better posture, poise and balance and that it will assist in improving the stance; that housework will be rendered less tiresome by wearing Cuboids; that the use of [the] device will afford increased foot health and comfort and beneficially assist in the distribution of body weight; that upon the correct position of the cuboid bone depends the relative position of every other bone in the foot, and that if these bones are maladjusted as to position the use of such device will serve or assist to normalize their position; and that calloused feet will be relieved by the use of Cuboids" ⁴ (I. R. 174-175).

³ Petitioner's brief arbitrarily breaks down the advertising statements in issue, with the result that some of them have lost their meaning (Pet. Br., pp. 4-5).

⁴ Said findings of the Commission are not contested by petitioner before this Court, either in its Statement of Points (I. R. 201-204), or in its Brief on petition to this Court, under "Questions Involved" and "Specifications of Error," or elsewhere in said Brief.

The Commission found further that "through use of the term 'Foot Balancers' in the designation and description of [his] device, [petitioner] additionally represent[ed] and indicate[d] that the use of [his] device will assist the wearer to balance the feet or body" (I. R. 175). (See footnote 4, *supra*.)

The Commission found that body balance in the foot and the maintenance of equilibrium depend primarily upon a tripod made up of the calcaneous (heel bone) and the first and fifth metatarsal heads, upon which a person stands, and the ligaments, tendons, muscles, and nerve supplies to those muscles; that most of the body weight thrust from the leg is received and distributed through the medial group of bones constituting the main arch of the foot, known as the longitudinal arch (I. R. 176). The cuboid bone is not included in the enumeration of said medial group of bones.

The Commission found that the human foot is constructed to adequately bear the weight of the body without any further aid to nature; that before correct treatment can be decided upon for foot trouble which requires realignment or readjustment of the foot bones, an accurate history must be obtained, including an expert diagnosis of the conditions causing the foot disorders. A layman cannot make such diagnosis. Treatment which may be beneficial for one foot may not be appropriate for the other foot of the same individual (I. R. 176-177).

The Commission found that petitioner's device does not grasp or grip sufficiently on the sides of the heel of the foot to correct any rolling tendencies of the heel or to significantly support the back of the heel; that the device would not be instrumental in throwing weight to the outer border of the foot, even in a case where such a modification might be desired, one reason for which is that the lateral elevations on each side of the device tend to balance each other out (I. R. 177-178).

The Commission found that petitioner's device would not substantially raise the frontal area of the foot in relationship to the heel bone and that such elevation as might be afforded might not be required in a particular case; that the device cannot affect the ligaments, the bony structures, or the neuromuscular mechanism entering into the balance of the foot; that

the elevations do not support or serve as the foundation for the cuboid bone (I. R. 178-179).

The Commission further found that foot disorders or foot troubles generally will not be benefited by wearing petitioner's device; that while foot troubles conceivably might be corrected or relieved through the relief of pressure in the metatarsal area if the device happened to fit correctly and the particular person happened to have a foot which was adapted to the device, such beneficial instances would be happenstances and merely occasional or rare; that, on the other hand, the use of petitioner's device might aggravate the condition which it was being used to correct (I. R. 179).

The Commission concluded that there was no reasonable probability that those wearing petitioner's shoe insert secured through fitting and recommendation of petitioner's representatives or sales personnel would receive the benefits which petitioner's representations promised would be afforded (I. R. 179-180).

The Commission further found that "the use of Cuboids will not assist the wearer to attain body balance or foot balance, or assist beneficially in the distribution of body weight. Such use will not be generally effective in affording the user better posture or poise or an improvement in stance nor will more normal or improved foot action result therefrom. The wearing of [petitioner's] device will not afford or increase general foot health. Although the wearing of Cuboids may in some instances aid strained, tired feet, [petitioner's] device cannot be relied upon to give comfort to users who have foot troubles or to correct or relieve conditions caused by misfitted shoes. [Petitioner's] device is not an effective treatment for ordinary foot aches and pains and has no therapeutic value in the treatment of aching or painful feet. Cuboids will not be generally effective in treating or relieving calloused foot conditions and the use of Cuboids cannot be relied upon to lessen the fatigue caused by housework or other physical effort" (I. R. 180.)

The Commission further found that "the wearing of Cuboids will not favorably influence the position, action or function of the Cuboid Bone, nor will such device realign, readjust or

normalize or improve the position of other bones of the feet" (I. R. 181).

Upon the basis of those findings of fact the Commission concluded (I. R. 183) that petitioner had violated the Federal Trade Commission Act, and entered its order (I. R. 183-186) directing petitioner, in the offering for sale, sale, or distribution of the device "Cuboids," or any device of substantially similar construction or composition, under whatever name sold, to cease and desist from representing directly or by implication:

(a) That the wearing of [petitioner's] device will assist in balancing the feet or body.

(b) That [petitioner's] device possesses therapeutic value for aching or painful feet.

(c) That the wearing of [petitioner's] device will enable the user to achieve better posture or poise or will improve the stance.

(d) That the wearing of [petitioner's] device will result in more normal foot action or improved foot action or foot health.

(e) That the wearing of [petitioner's] device will afford increased comfort for the feet or decrease the fatigue resulting from housework or other physical efforts except to the extent that [petitioner's] device may in instances reduce or relieve the discomfort associated with strained or tired feet.

(f) That the wearing of [petitioner's] device will have beneficial effect upon the distribution of body weight.

(g) That the wearing of [petitioner's] device will in any way aid the Cuboid Bone or its position or stability with respect to other bones of the feet or will serve to readjust, realign, normalize or improve the position of the bones of the feet.

(h) That said device possesses therapeutic value in the treatment of calloused feet.

* * * * *

2. Disseminating or causing to be disseminated any advertisement by any means for the purpose of inducing or which is likely to induce, directly or indirectly, the

purchase of said product in commerce, as "commerce" is defined in the Federal Trade Commission Act, which advertisement contains any representation prohibited in Paragraph 1 hereof.

Thereafter a petition for review was timely filed by James H. Sewell, who also filed specifications of points relied upon as required by the rules of this Court. Some of these points are not developed in petitioner's brief and therefore are abandoned *Donnelley v. United States*, 276 U. S. 505, 511 (1928); *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U. S. 359, 369 (1927).

II. QUESTIONS PRESENTED

We believe it would be of benefit to the Court to briefly outline the procedure covering matters of this nature in effect at the time this case was before the Commission. Under the Commission's Rules of Practice the hearing examiner was required to make and file his initial decision within thirty days from the date of the order closing the case before him. His decision would become the decision of the Commission thirty days after service upon petitioner unless prior thereto (1) an appeal was filed under the provisions of Rule XXIII, (2) the Commission by order stayed the effective date of the initial decision, or (3) the Commission on its own initiative placed the case on its review calendar.

The hearing examiner made his initial decision containing findings as to the facts, conclusions, and order to cease and desist on December 31, 1952 (I. R. 131-143). After service of the initial decision upon him petitioner complied with the provisions of Rule XXIII of the Commission's Rules of Practice by filing on March 10, 1953, an appeal to the Commission from the initial decision of the hearing examiner. Thereafter, on March 12, 1954, the Commission made two separate but related decisions. One was interlocutory, the other final. The interlocutory decision was a ruling by the Commission on petitioner's appeal from the initial decision of the trial examiner, which included rulings by the Commission on exceptions taken to alleged errors in procedure, conduct, and rulings of the examiner (I. R. 150-169). The other was the final decision of the Com-

mission on the merits, and included the Commission's findings as to the facts, conclusions, and order, entered by the Commission in lieu of the initial decision of the examiner (I. R. 170-186).

The final decision of the Commission on the merits is the only decision which, under the Federal Trade Commission Act, is subject to review by a court of appeals. This Court, of course, under its review powers can examine the interlocutory decisions rendered by the Commission to determine whether the Commission's rulings on alleged errors committed by the examiner are of such a nature as to materially affect the validity of the findings as to the facts and the order to cease and desist entered by the Commission.

In his brief petitioner ignores the above procedure and fails to distinguish between the initial decision of the examiner (I. R. 131-143), the interlocutory decision by the Commission on petitioner's appeal from the initial decision of the examiner (I. R. 150-169), and the final determination of this case on its merits by the Commission (I. R. 170-186).

Under the heading "Specifications of Error" petitioner lists some 23 alleged errors made by the examiner and some 7 alleged errors made by the Commission (Br., pp. 8-11). An examination of these errors discloses that each of them falls into one or more of the following classifications: (a) errors made by the examiner rather than errors made by the Commission in its rulings on the alleged errors made by the examiner,⁵ (b) errors not raised before the Commission by petitioner on his appeal from the initial decision of the examiner, (c) errors which are not included by petitioner in his statement of points relied upon filed in this Court, and (d) errors which are not stated with clarity and particularity, as required by subsection 2 (d) of Rule 18 of the Rules of Practice of this Court.

Subjecting petitioner's specifications of error to the above classifications, the following results are obtained: (a) of the 23 errors alleged to have been committed by the examiner only 5 were raised before the Commission by petitioner in his appeal from the initial decision of the examiner, error Nos. 1, 2,

⁵ Errors made by the examiner are not, as such, subject to review by a court of appeals.

3, 4, and 5, and, of these only error Nos. 2, 4, and 5 were included by petitioner in his statement of points relied upon filed in this Court, and none of these is stated with the clarity and particularity required by Rule 18-2 (d) of this Court; (b) of the 7 errors alleged to have been committed by the Commission, error Nos. 1, 2, 3, 4, and 7 were not included in the statement of points relied upon, filed in this Court by petitioner, and error Nos. 3, 4, 5, 6, and 7 were not stated with the clarity and particularity required by subsection 2 (d) of Rule 18 of this Court's Rules of Practice.

One of the applicable rules of practice of the Commission at the time of the hearing below required that Petitioner's appeal brief contain "exceptions to any prejudicial error in procedure, including conduct or ruling of the trial examiner" (Rule XXIII C. (3)) and that "no matter not included in the appeal brief may thereafter be presented to the Commission, in oral argument or otherwise" (Rule XXIII D.). These provisions of this rule were designed to make applicable to procedure before the Commission a policy that the courts of appeals had followed in their review of administrative action—the policy of exhausting administrative remedy before the court would act.

Ordinarily an appellate court does not give consideration to issues which petitioners have not raised below. *Hormel v. Helvering*, 312 U. S. 552, 556 (1941). One of the reasons for this is that failure to raise the issues below deprives the court of the benefit and assistance of a decision by the triers of fact. *Helvering v. Tex-Penn Co.*, 300 U. S. 481, 498 (1937). For as the Supreme Court said in *United States v. L. A. Tucker Truck Lines, Inc.*, 344 U. S. 33, 36-37 (1952):

We have recognized in more than a few decisions, and Congress has recognized in more than a few statutes, that orderly procedure and good administration require that objections to the proceedings of an administrative agency be made while it has opportunity for correction in order to raise issues reviewable by the courts. * * * Simple fairness to those who are engaged in the tasks of administration, and to litigants, requires as a general rule that courts should not topple over administrative

decisions unless the administrative body has not only erred but has erred against objections made at the time appropriate under its practice.⁶

In addition to the above decision of the courts and the applicable rule of the Commission, one of the rules of practice of this Court has a very definite bearing on whether an issue is properly before the court. This Court has deemed it important to require a petitioner seeking a review of an order of an administrative agency to "file with the clerk a concise statement of the points on which he intends to rely" (Rule 17 (6)). This Court has enforced this rule by refusing to consider arguments in a petitioner's brief on points not included in the statement of points relied upon. *State Farm Mutual Auto Insurance Co. v. Porter*, 186 F. 2d 834, 845 (C. A. 9, 1950); *Refrigeration Engineering, Inc. v. York Corporation*, 168 F. 2d 896, 899 (C. A. 9, 1948), cert. denied 335 U. S. 859 (1948).⁷

We therefore respectfully submit that due to the fact that the alleged errors set forth in petitioner's brief under "Specifications of Error" were either (a) not raised before the Commission, or (b) were not included by petitioner in the statement of points relied upon, or (c) were not stated with the clarity and particularity required by the applicable rule of this Court, petitioner has not properly raised and presented any question or issue in this matter under his petition for review. This Court could very well, and properly so, dismiss the petition for review without further consideration.

In his brief petitioner attempts to develop the following questions:

1. Are the Commission's findings supported by substantial evidence?
2. Are the Commission's findings inconsistent?

⁶ To the same effect, see *Unemployment Compensation Commission of Alaska v. Aragon*, 329 U. S. 143, 155 (1946); *Adams v. Mills*, 286 U. S. 397, 416-417 (1932); *United States ex rel. Beck v. Ncelly*, 202 F. 2d 221, 224 (C. A. 7, 1953), cert. denied 345 U. S. 997 (1953); *Transamerican Freight Lines v. United States*, 51 Fed. Supp. 405, 412 (D. C. Del., 1943). (Consideration of alleged error not raised before entire Interstate Commerce Commission would permit applicant "to ambush the Commission.")

⁷ To the same effect, see *Pennsylvania Railroad Co. v. Public Utilities Commission of Ohio*, 298 U. S. 170, 177 (1936); *Cohen v. United States*, 142 F. 2d 861, 863 (C. A. 8, 1944).

3. Did the hearing examiner commit prejudicial and reversible error by reason of various rulings?

4. Was petitioner afforded a fair trial?

Even though, for one or more of the above reasons, these questions are not properly before this Court, the remaining portions of this brief will be in reply to petitioner's argument under those headings.

III. ARGUMENT

Preliminary statement

It is too well settled to require argument that the Commission's findings as to the facts, if supported by substantial evidence, are conclusive. The statute so provides, and this Court has often so held.⁸ This well-settled rule applies with as much force to findings with respect to which there is a conflict in expert testimony, medical or otherwise, as it does to other findings.⁹ It also applies where there is conflict between experts who had never used the product involved and experts who had,¹⁰ and applies where there is conflict between expert testimony and testimony of lay witnesses who have used the product,¹¹ for it is well settled that the weight and credibility of the testimony are for the triers of the facts to determine.¹²

⁸ Federal Trade Commission Act, Sec. 5 (c) ; 52 Stat. 112-113 ; 15 U. S. C. Sec. 45 (c) ; *Howe v. Federal Trade Commission*, 148 F. 2d 561, 562 (C. A. 9, 1945), cert. denied, 326 U. S. 741 (1945) ; *American Medicinal Products v. Federal Trade Commission*, 136 F. 2d 426, 427 (C. A. 9, 1943) ; *Lane v. Federal Trade Commission*, 130 F. 2d 48, 50 (C. A. 9, 1942) ; *Alberty v. Federal Trade Commission*, 118 F. 2d 669, 670 (C. A. 9, 1941), cert. denied 314 U. S. 630 (1941).

⁹ *Alberty v. Federal Trade Commission*, 118 F. 2d 669, 670 (C. A. 9, 1941), cert. denied 314 U. S. 630 (1941).

¹⁰ *John J. Fulton Co. v. Federal Trade Commission*, 130 F. 2d 85, 86 (C. A. 9, 1942), cert. denied 317 U. S. 679 (1942) ; *Bristol-Myers Co. v. Federal Trade Commission*, 185 F. 2d 58, 62 (C. A. 4, 1950) ; *J. E. Todd, Inc. v. Federal Trade Commission*, 145 F. 2d 858 (C. A. D. C., 1944) ; *Justin Haynes & Co. v. Federal Trade Commission*, 105 F. 2d 988, 989 (C. A. 2, 1939), cert. denied 308 U. S. 616 (1939).

¹¹ *Vacu-Matic Carburetor Co. v. Federal Trade Commission*, 157 F. 2d 711, 713 (C. A. 7, 1946), cert. denied 331 U. S. 806 (1947) ; *Irvine v. Federal Trade Commission*, 143 F. 2d 316, 323-324 (C. A. 8, 1944).

¹² *United States v. Johnson*, 319 U. S. 503, 519 (1943). See also *Leach v. Carlile*, 258 U. S. 138, 139-140 (1922).

The Federal Trade Commission Act expressly prohibits the dissemination of false advertisements intended or likely to induce the purchase of any "device," and it empowers the Commission to determine whether such advertisements are true or false.¹³ The Commission would be rendered powerless, and the statute meaningless, if the existence of a conflict in testimony as to the falsity of advertisements of a "device" precluded a finding that they were untrue, for the court may well judicially notice that it is not difficult to obtain "expert testimony" and "lay testimony" in support of claims made for any proprietary nostrum or device.

We are not here concerned with "mere matters of opinion upon subjects which are incapable of proof as to their falsity." *American School of Magnetic Healing v. McAnnulty*, 187 U. S. 94, 104 (1902). We are dealing instead with the question of the therapeutic value of a "device" to be worn in the shoes, a matter "susceptible of demonstration and proof,"¹⁴ and four well-qualified medical experts¹⁵ testified that petitioner's device would not effect the results claimed for it. That being true, the Commission was not bound to accept as sound the opinions of petitioner's experts or his lay witnesses,¹⁶ and the fact that they testified contrary to the experts offered by the Commission "cannot enable petitioner to contend successfully that there was no substantial evidence to support the Commission's findings." *Justin Haynes & Co. v. Federal Trade Commission*, 105 F. 2d 988, 989 (C. A. 2, 1939), cert. denied 308 U. S. 616 (1939). As the court said in *Aronberg v. Federal Trade Commission*, 132 F. 2d 165, 170 (C. A. 7, 1942):

True, the Commission's evidence was zealously controverted by petitioner. But the triers of the facts were in a position to weigh the testimony and the credibility

¹³ Federal Trade Commission Act, Secs. 5, 12, 15; 52 Stat. 111, 114, 116; 15 U. S. C., Secs. 45, 52, 55.

¹⁴ Cf. *Farley v. Heininger*, 105 F. 2d 79, 84 (C. A. D. C., 1939), cert. denied 308 U. S. 587 (1939).

¹⁵ A summary of the qualifications of these experts appears in the appendix, post, pp. 26-28.

¹⁶ Cf. *Helvering v. National Grocery Co.*, 304 U. S. 282, 295 (1938).

of the witnesses. In view of substantial evidence to support the findings and our lack of authority to pass upon credibility or weight of evidence, they must be upheld.

Petitioner does not question those well-established principles. He does contend that the Commission's findings as to the facts are not supported by substantial evidence. Unless petitioner points to the specific finding which is not so supported, his contention raises no issue. The Commission's findings are presumed to be supported by "substantial evidence." *Federal Trade Commission v. A. McLean & Son*, 84 F. 2d 910, 911 (C. A. 7, 1936). This Court cannot be "compelled to search the record for undesignated error claimed upon an omnibus assertion" that the findings are unwarranted. *North Whittier Heights Citrus Ass'n v. National Labor Relations Board*, 109 F. 2d 76, 83 (C. A. 9, 1940), cert. denied 310 U. S. 632 (1940).

Petitioner admits that on direct examination three of the expert medical witnesses who testified in support of the complaint testified that his representations as to the benefit to be obtained from using his product were false (Br., pp. 29-30), but claims that that testimony "must fall before the analytical, detailed statements given by them on cross-examination" (Br., p. 29). Petitioner attempts to argue this point solely by reproduction of portions of the cross-examination of these doctors (Br., pp. 31-53) without explaining how or in what way such cross-examination destroys their direct testimony that his representations were false.

In addition to the foregoing generalization, petitioner has specifically attacked only three of the Commission's findings. These are the findings as to the effect of the use of his device on "balance," "callouses," and "ordinary foot aches and pains."

In view of the above, our argument under the question of whether the Commission's findings are supported by substantial evidence will be limited to the cross-examination question and those findings which petitioner specifically points to in his brief.

A. The Commission's findings as to the facts are supported by substantial evidence

1. *Testimony of the expert witnesses reproduced by petitioner in fact support the findings of the Commission*

The testimony relating to possible benefits of the device (Pet. Br., pp. 31-53) strengthens and supports the Commission's finding that foot disorders or foot troubles generally will not be benefited by wearing Burns Cuboids; that the only way foot troubles could be corrected or relieved by respondent's device would be through the relief of pressure in the metatarsal area, but only in occasional or rare instances where Cuboids might accidentally serve beneficially to change the area of pressure; but that on the other hand the use of respondent's device might aggravate the condition which it was being used to correct (I. R. 179).

This finding of the Commission is further supported by the fact that Dr. Engh testified that no foot trouble would be benefited by Cuboids except if by accident a support might fit the foot of a particular patient who happened to need such support in the metatarsal area (II. R. 20-21); that foot discomforts caused by misfitting shoes could not be corrected or relieved by using Cuboids unless by chance some pressure of the metatarsal area in a particular individual's foot might be corrected or relieved, but then only to a slight extent (II. R. 27); that discomfort might occasionally be relieved where a particular part of the metatarsal arch has some pressure removed from it, but this is not to be expected in the average case of foot trouble (II. R. 33); but that instead of the slight relief in the metatarsal area that might in such rare cases be achieved, the device might aggravate the condition (II. R. 61); and Dr. Masterson's testimony that in an occasional case, through happy circumstances and where there happened to be an exact fit, there might be some relief (II. R. 68-69); that in a rare case, if there happened to be a need for balance in the metatarsal area and if the need for balance should be determined by a person well trained and versed in foot pathology, not a shoe salesman, the device might help (II. R. 72-73).

The testimony II. R. 83-85 (Pet. Br., pp. 40-42) supports the Commission's finding that one reason why the device can-

not throw the weight to the outer border of the foot is that both sides of the device are raised and there is the tendency for the lateral elevations to balance each other out (I. R. 178).

Testimony in petitioner's brief, pp. 42-44, indicates the witness' opinion as to the insignificant function of the cuboid bone.

None of the remaining portions of testimony reproduced lends any support to petitioner's contention.

2. *Petitioner's device is not an effective treatment for ordinary foot aches and pains and has no therapeutic value in the treatment of aching or painful feet*

Dr. Engh testified that the device would be ineffective in the treatment or remedy of foot troubles generally (II. R. 29, 32), would have no effect on ordinary foot aches and pains, and would not exert any influence on the delicate nerve centers or arteries, nor would it relieve pressure therefrom (II. R. 31-32), or from the most sensitive parts of the foot (II. R. 29).¹⁷

Dr. Lewin, in rebuttal of witnesses produced by petitioner, testified that the device would furnish no mechanical aid to pains caused by foot trouble (IV. R. 843).

Petitioner's contention here is based on the testimony of lay witnesses that they had been benefited by using petitioner's product and that the Commission had ignored this testimony in making its findings of fact.

This contention has to do with the credibility and weight of the testimony, and it is well settled that this is for the Commission to determine (see text and cases cited *supra*, p. 11-13), and where there is expert testimony that petitioner's product has no therapeutic value in the treatment of any foot aches and pains, or in the treatment of aching feet, the Commission was not bound by the testimony of petitioner's lay witnesses.

3. *Petitioner's device will not be generally effective in treating or relieving calloused foot conditions*

Drs. Engh and Masterson testified that Burns Cuboids could not be relied upon to relieve calloused foot conditions (II. R. 29, 31, 73, 76). Dr. Masterson testified that callouses in the metatarsal area of the foot caused by high heels could not be

¹⁷ Dr. Masterson testified to the same effect (II. R. 73, 75-77), as did Dr. Mosiman (II. R. 108, 114, 116-118).

relieved by Burns Cuboids (II. R. 101). Dr. Mosiman testified to the same effect (II. R. 114, 116, 140).

The first portion of testimony reproduced by petitioner (Pet. Br., pp. 59-60) reveals that Dr. Engh was limiting himself to the rare instances where the elevation in the metatarsal area of the device might happen to strike behind the area that is being depressed, in which case there might be some relief (II. R. 51a-51b); that the device will not tend to remove pressure from the most sensitive parts of the foot (II. R. 29), except by accident (II. R. 20-21, 39); that even in such instances the device might aggravate the situation (II. R. 61).

The next portion of reproduction is from the testimony of Dr. Masterson (Pet. Br., p. 60; II. R. 68-69). Dr. Masterson explains he is talking of an occasional case where through a happy circumstance of an exact fit the device in question might help. He further testified:

Well, if it happens to fit correctly and the particular person happened to have a foot which was adapted to this device, then the position of this metatarsal pad might happily hit the right spot, but that certainly would be asking for a lot of coincidences to occur, which we cannot ask for, as a rule (II. R. 83).

Petitioner's reference to Dr. Mosiman's general testimony as to the causes of callouses and the various treatments used to relieve pressure from calloused areas (Pet. Br., pp. 60-61) does not lend support to petitioner's contentions. Dr. Mosiman stated that supports are prescribed and applied in combinations, depending entirely upon the particular patient's foot, at varied points under the sole of the foot (II. R. 132-133). The doctor explained that in placing supports to relieve pressure, an area of $\frac{1}{8}$ inch can make a great deal of difference and that left feet vary from right feet by as much as half a size; hence Cuboids, which are sold in identical pairs, could not help both feet even if one foot might, in a particular case, be aided (II. R. 141).

The testimony of Drs. Hiss and Garner, witnesses for petitioner, that the forepart of the Cuboid device will relieve pressure and treat callouses in much the same manner as a Thomas

Bar (Pet. Br., p. 61) was absolutely rebutted by Dr. Philip Lewin (IV. R. 846, 848).

Petitioner's attempt to credit the Cuboid device with the attributes of the Jones Bar and the Lewin Rubber Metatarsal Crescent (Pet. Br., pp. 61-62) is completely rebutted by Dr. Lewin's testimony that his Rubber Metatarsal Crescent is a modification of the Jones Bar (IV. R. 936), whereas the Burns Cuboid is absolutely dissimilar (IV. R. 847).

In Dr. Lewin's testimony referred to at page 61 of petitioner's brief, he specified that the various elevations he uses are always prescribed individually or in combinations on the basis of individual needs (Pet. Br., p. 65; IV. R. 939-940) as the various pads or elevations required vary from patient to patient, both in combinations of pads to be used and in relative sizes or thicknesses (IV. R. 939-950).

4. Petitioner's device will not assist the wearer to attain body balance or foot balance, or assist beneficially in the distribution of body weight

The expert witnesses in support of the complaint testified that nature has designed the human foot to fulfill the function of weight bearing without outside assistance, a more stable equilibrium is not required (II. R. 32, 77, 118); that wearing the device would be of no assistance in attaining body or foot balance (II. R. 21, 22, 27, 69, 70, 72-73, 108, 113); that one of the reasons Cuboids will not serve or help to balance the foot is because it cannot possibly affect the ligaments, the bony structures, or the neuromuscular mechanism which enters into balance of the foot (II. R. 24-25, 48); that the device in question will not tend to distribute weight or weight bearing to the most appropriate places of the foot for weight bearing (II. R. 29-30, 74); that the cuboid bone is relatively unimportant in body balance and weight distribution (II. R. 22-23, 26, 70, 86, 110, 111); that in walking the foot does not tend to roll to either side, but tends to go straight ahead (II. R. 86); that the device in question will not adapt itself to the shape of the foot, but that the contour reflects the natural wear of leather in the shoe (II. R. 92, 99-100; IV. R. 864-865); that the ordinary or average American shoe on a normal foot requires no device to prevent rotation of the heel bone; that the normal

American shoe does not have an unnatural surface for the foot to rest on, does conform to the anatomy of the foot and is made for normal foot functions, and said shoes do not hinder the proper distribution of body weight (IV. R. 862-863); and that Burns Cuboids will not overcome and correct the consequences of improper shoes (II. R. 58; IV. R. 867) will not help the heel in weight distribution, will not help keep the heel from rolling or wobbling (IV. R. 842-843), and will not provide a balanced foundation in the shank of the shoe (IV. R. 845).

Dr. Philip Lewin additionally testified that the device in question would not correct feet that are off center and restore them to normal position, would not restore the weight-bearing line to its normal position, would not balance or affect the balance of the human body, would not help balance the foot or affect foot balance, would not aid in balancing the heel, would not throw the weight or keep the body weight balanced on the outer side of the foot, would not keep the foot from rolling toward the inner side, would not cause the heel to roll to the outer side, and would not aid in the balancing of the properly distributed body weight (IV. R. 842-845).

Petitioner attempts to escape the effect of the above testimony by explaining the meaning he places upon the word "balance" when used in his advertisements and attempts to support or clarify this meaning by a demonstration during the hearing. He placed rubber erasers on either side of a rounded glass paperweight to prove that they would prevent the glass paperweight from rolling. Since "words mean what people understand them to mean," *Benton Announcements v. Federal Trade Commission*, 130 F. 2d 254, 255 (C. A. 2, 1942), we submit it is wholly immaterial what petitioner understands the word "balance" to mean. The use of a rounded glass paperweight scotched on either side by two rubber erasers in an effort to demonstrate the actual operation of the human foot in walking is far removed from the realities of the case, and Dr. Engh so testified (II. R. 49-51a).

We therefore respectfully submit that petitioner's contention that the findings as to the facts made by the Commission are not supported by substantial evidence is devoid of merit.

B. The Commission's findings are consistent

On page 55 of his brief petitioner sets forth subsection (b) of Paragraph Ten of the Commission's findings (I. R. 182-183) and lifts one section from Paragraph Eight of the findings (I. R. 180) and contends that the one is inconsistent with the other. This contention is without substance or foundation.

In his appeal to the Commission from the initial decision of the examiner, petitioner raised this same issue. The Commission ruled on this as follows:

* * * It appears from the record that in some instances, just as in the case of changing from one shoe to another, the placing of an insert in a shoe may temporarily relieve fatigue, and it is equally clear that chronic discomfort from strained feet may be caused by something which respondents' product may be of no value in correcting. Irrespective of such value as respondents' device in instances may have in reducing or relieving lack of comfort associated with strained or tired feet, the greater weight of the evidence clearly establishes that it has no therapeutic value or value from an orthopedic standpoint for relieving aching or painful feet. No conflict is presented, therefore, as to the rulings in question and this exception is being denied (I. R. 155).

and made the following finding as to the facts:

Although the wearing of Cuboids may in some instances aid strained, tired feet, respondent's device cannot be relied upon to give comfort to users who have foot troubles or to correct or relieve conditions caused by misfitted shoes. Respondent's device is not an effective treatment for ordinary foot aches and pains and has no therapeutic value in the treatment of aching or painful feet (I. R. 180).

It is clear from the above that the Commission has not found that respondent's device is an effective treatment for strained, tired feet or that it has therapeutic value in the treatment of strained, tired feet.

Petitioner also contends (Br., pp. 73-74) that the Commission's finding that since both sides of the device are raised "there is the tendency for these lateral elevations to balance one another out" (I. R. 178) is inconsistent with the finding that "the use of Cuboids will not assist the wearer to attain body balance or foot balance, or assist beneficially in the distribution of body weight" (I. R. 180). There is no more merit to this than there is to the alleged inconsistency just above discussed.

The Commission found that the equal lifts on each side of the device would balance each other out, and neither lift would have any effect on body weight or distribution. The Commission was not finding that the device had any balancing effect, but was finding that it had no such effect because each elevation was counteracted or "balanced out" by the other. This finding of the Commission, as well as its choice of language, is substantiated by the testimony of Dr. Masterson (I. R. 83-85).

C. Alleged errors of the hearing examiner¹⁸

1. *Refusal to admit the patent into evidence was not error*

A patent does not authorize the patentee to misrepresent his product, regardless of the nature of representations carried into the letters-patent. And petitioner's contention that it was error to refuse to admit petitioner's patent in evidence is without merit. A short reply, if any is necessary, is found in *Decker v. Federal Trade Commission*, 176 F. 2d 461 (C. A. D. C., 1949) cert. denied, 338 U. S. 878 (1949)¹⁹ where the Court stated:

It has long been settled that a patentee receives nothing from the law he did not have before, and that the only effect of his patent is to restrain others from manufacturing, using or selling that which he has in-

¹⁸ The errors discussed under this heading, although not properly raised before the Court, were raised before the Commission.

¹⁹ And see cases cited therein. See, also *Federal Trade Commission v. Winsted Hosiery Company*, 258 U. S. 483, 494 (1922); *Irwin v. Federal Trade Commission*, 143 F. 2d 316, 325 (C. A. 8, 1944); *Charles of the Ritz Distributors Corporation v. Federal Trade Commission*, 143 F. 2d 676, 679 (C. A. 2, 1944) to the effect that the registration of a trademark or trade name is no defense to its use to deceive the public.

vented. *Motion Pictures Patents Co. v. Universal Film Manufacturing Co.*, *supra*, and cases cited. Before the patent grant the inventor had the right to sell the product of his invention and to advertise the same, but not the right to misrepresent it. Now, after the patent grant, petitioners, the present owners of the patent, have the right to sell the article and to advertise it, but not the right to misrepresent it. In short, the letters-patent do not cover advertising (at p. 463).

2. Refusal to admit the prescriptions into evidence was not error

Petitioner contends that the examiner committed error in refusing to admit into evidence certain prescriptions of doctors prescribing the use of the device. On appeal to the Commission from the initial decision of the examiner, petitioner raised and argued this issue. The Commission sustained the examiner. Petitioner states that he offered these prescriptions "to refute the testimony elicited by the attorney in support of the Complaint that the medical profession all over the United States would have nothing to do with the product" (Pet. Br., p. 14).

There is no merit to the contention for three reasons. First, these exhibits were pure hearsay evidence; second, there is no such testimony in the record as that sought to be rebutted; and, third, petitioner was not prejudiced by the action of the examiner inasmuch as verbal testimony, offered by petitioner, coextensive with the offer of proof was admitted in evidence. *McKee v. Jamestown Baking Co.*, 198 F. 2d 551, 556 (C. A. 3, 1952).

Mr. Sewell, the petitioner, was allowed to testify to the effect that many customers appeared with doctors' prescriptions (II. R. 303-304). Petitioner's attorney stated this verbal testimony would cover all that was offered to be proved by the exhibits (II. R. 290). The offer of proof having been restricted to the fact that customers appeared with prescriptions for Cuboids, the contents or form of the prescriptions not having been in issue, the admission into evidence of the prescriptions themselves would have added nothing to Mr. Sewell's testimony that many sales were made on prescriptions.

3. Refusal to admit the testimonials into evidence was not error

Petitioner here contends that the examiner committed error in refusing to admit into evidence certain testimonials of users of his product. On appeal to the Commission from the initial decision of the examiner this issue was raised and argued. The Commission sustained the action of this examiner.

A short reply to petitioner's contention here is that testimonials of this nature are hearsay and have no probative value (*United States v. 50³/₄ Dozen Bottles*, 54 Fed. Supp. 759, 763 (D. C. Mo., 1944)).

4. Refusal by the hearing examiner to reopen the defense to receive the testimony of Dr. Glassman was not error

Petitioner contends that the examiner committed error in refusing to grant petitioner's request to reopen his defense to enable him to introduce the testimony of Dr. Glassman. When the examiner denied petitioner's request, petitioner submitted an offer of proof (I. R. 77-82). On appeal to the Commission from the initial decision of the examiner, petitioner raised and argued the issue. The Commission sustained the examiner's refusal to reopen and stated in so doing it had considered the matter set forth in petitioner's offer of proof to the same extent as though Dr. Glassman had testified (I. R. 168). In its final determination of the matter on its merits the Commission gave full consideration to petitioner's offer of proof (I. R. 168, 175-176).

The issue here is not properly before the Court, and, since the Commission gave full consideration to the matters in petitioner's offer of proof, the question here raised is moot.

5. Refusal to strike the 58 specified portions of testimony was not error

At the hearing below petitioner filed a motion before the examiner to strike from the record 58 specified portions of opinion testimony given by qualified medical experts. The grounds for petitioner's motion were that since he had not been permitted to ask questions of a similar nature of his witnesses, then specified opinions given by the Commission's witnesses should be stricken. The examiner denied petitioner's motion.

On appeal to the Commission the examiner's ruling was sustained.

There is no merit for petitioner's contention here. An examination of the pertinent portions of the record (II. R. 250-251, 255-256) clearly reveals the nature of questions asked by petitioner and the reason why he was not permitted to ask those questions.

Petitioner's questions were as to the truth or falsity of the advertising statements in issue. The hearing examiner explained to petitioner that the experts could be asked their opinions as to what the device in question would do, but not their opinions as to the truth or falsity of an advertising statement; that the truth or falsity of his representations as to his product was a matter for the ultimate decision of the Commission and not a matter to be directly testified to (II. R. 255-256).

Petitioner expressed his understanding of the distinction between the two types of questions and proceeded to elicit proper opinion testimony from the witness (II. R. 256-257). Not one of the questions and answers covered by petitioner's motions to strike was directed to the truth or falsity of petitioner's advertisements.

D. Petitioner was afforded a fair trial

Petitioner contends that he was denied a fair trial by reason of (a) the administrative system of the Federal Trade Commission, and (b) the attitude and rulings of the examiner. In developing this contention petitioner wanders far afield.

He contends that the Commission has acted as complainant-prosecutor and judge, has influenced the examiner by its complaint, that the examiner has influenced the Commission by his initial decision, and that the Commission has interpreted in its favor the advertisements which it complained of as being false and misleading, all of which, so says petitioner, has resulted in denying him a fair trial.

Petitioner's entire argument (Br., pp. 19-31) is devoid of merit. An answer, if any is necessary, is that as long ago as 1920 the contention that the Federal Trade Commission Act was unconstitutional because of the dual function required of the Commission was rejected by the courts. In *National Harness Mfrs.' Ass'n v. Federal Trade Commission*, 268 Fed.

705, 707 (1920), the Sixth Circuit observed that such contention "is too unsubstantial to justify discussion." The Supreme Court in *Federal Trade Commission v. Klesner*, 280 U. S. 19, 27 (1929), recognized the necessity of the Commission functioning in a dual capacity, observing that the Commission "exercises functions of both prosecutor and judge."

Further than this, petitioner fails to point out in what way and in what manner the examiner's attitude and rulings were of such a nature as to deprive him of a fair trial. Without a proper showing of this, petitioner's contention raises no issue here.

IV. CONCLUSION

The Commission therefore prays that the petition to review be dismissed, and that pursuant to the statute²⁰ the Court enter its decree affirming the Commission's order to cease and desist and commanding petitioner to obey the same and comply therewith.

Respectfully submitted.

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General Counsel,

ROBERT B. DAWKINS,
Assistant General Counsel,

ALVIN L. BERMAN,
Attorney,

Attorneys for the Federal Trade Commission.

Washington, D. C.

June 1955.

²⁰ "To the extent that the order of the Commission is affirmed, the court shall thereupon issue its own order commanding obedience to the terms of such order of the Commission." Federal Trade Commission Act, Sec. 5 (c), 52 Stat. 113, 15 U. S. C. 45 (c).

APPENDIX

PERTINENT PROVISION OF THE FEDERAL TRADE COMMISSION ACT:

SEC. 5. (a) (1) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

* * * * *

(6) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations * * * from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce (66 Stat. 632; 15 U. S. C. 45 (a)).

(b) Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. * * * If upon such hearing the Commission shall be of the opinion that the method of competition or the act or practice in question is prohibited by this Act, it shall make a report in writing in which it shall state its findings as to the facts and shall issue and cause to be served on such person, partnership, or corporation an order requiring such person, partnership, or corporation to cease and desist from using such method of competition or such act or practice. * * * (52 Stat. 112; 15 U. S. C. 45 (b)).

(c) * * * The findings of the Commission as to the facts, if supported by evidence, shall be conclusive. To the extent that the order of the Commission is affirmed, the court shall thereupon issue its own order commanding obedience to the terms of such order of the Commission. (52 Stat. 113; 15 U. S. C. 45 (c).)

SEC. 12. (a) It shall be unlawful for any person, partnership, or corporation to disseminate, or cause to be disseminated, any false advertisement—

(1) By United States mails, or in commerce by any means, for the purpose of inducing, or which is likely to induce, directly or indirectly the purchase of food, drugs, devices, or cosmetics; or

(2) By any means, for the purpose of inducing, or which is likely to induce, directly or indirectly, the purchase in commerce of food, drugs, devices, or cosmetics.

(b) The dissemination or the causing to be disseminated of any false advertisement within the provisions of subsection (a) of this section shall be an unfair or deceptive act or practice in commerce within the meaning of section 5 (52 Stat. 114–115; 15 U. S. C. 52).

SEC. 15. * * * (a) The term “false advertisement” means an advertisement, other than labeling, which is misleading in a material respect; * * *. (52 Stat. 116; 15 U. S. C. 55 (a).)

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(d) The term “device” * * * means instruments, apparatus, and contrivances, including their parts and accessories, intended (1) for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in man or other animals; or (2) to affect the structure or any function of the body of man or other animals (52 Stat. 116; 15 U. S. C. 55 (d)).

SUMMARY OF QUALIFICATIONS OF COMMISSION'S EXPERTS

Dr. Otto Anderson Engh

Dr. Engh, orthopedic specialist for 15 years, is chief of staff of the Anderson Orthopedic Clinic and chief orthopedist of

several hospitals in the Washington, D. C., area; chief consultant in orthopedics for the United States Public Health Service in the Washington, D. C., area; faculty member of George Washington University Medical School for 10 years; member of the American Medical Association, American Academy of Orthopedic Surgeons; president of the Virginia Orthopedic Society; and diplomat of the American Board of Orthopedic Surgery. He sees approximately 100 foot cases each week (II. R. 11-18) and has seen a couple of hundred patients who wore petitioner's device (II. R. 37).

Dr. James Hugh Masterson

Dr. Masterson, medical doctor, is an orthopedic specialist, having spent three years at that specialty in the Army, followed by private practice including three years' orthopedic work at the Anderson Orthopedic Clinic and at his private office, and is connected with various hospitals in the Washington, D. C., area. This doctor has seen over 100 patients wearing petitioner's device (II. R. 63-67).

Dr. Roscoe S. Mosiman

Dr. Mosiman, orthopedic surgeon, taught orthopedic surgery at Tulane University for two years and has addressed the American Academy of Orthopedic Surgeons and the American College of Surgeons. Dr. Mosiman served an orthopedic internship at Johns Hopkins Hospital at Baltimore, Maryland, and was chief of section of an orthopedic hospital in the Army, after which he returned to Johns Hopkins Hospital as an orthopedist (II. R. 104-107).

Dr. Philip Lewin

Dr. Lewin, an active orthopedic surgeon since 1915, has done extensive post-graduate work in orthopedics in this country and abroad. He is Professor of Bone and Joint Surgery and chairman of the Department of Bone and Joint Surgery at Northwestern Medical School in Chicago, and Professor of Orthopedic Surgery at the Post Graduate Medical School of Cook County.

He is a diplomat on the American Board of Orthopedic Surgery; a fellow in the American College of Surgeons, the Interna-

tional College of Surgeons, and the American Medical Association; and a member of the Clinical Orthopedic Society, the American Academy of Orthopedic Surgery, and the American Orthopedic Society, among others. He has received signal honors from numerous medical associations.

He has been a contributor to many standard medical works and is the author of numerous publications and books in the field of orthopedics, including current editions of the book "Foot and Ankle" (IV. R. 818-827).

No. 14354

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAMES H. SEWELL, Doing Business Under the Fictitious
Firm Name and Style of Burns Cuboid Company,
Petitioner,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

PETITIONER'S REPLY BRIEF.

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Los Angeles 5, California,
Attorneys for Petitioner.

FILED

AUG - 1 1955

PAUL P. O'BRIEN, CLERK



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PETITIONER'S REPLY BRIEF.

Foreword.

The writer of the Federal Trade Commission's brief, it would seem, has not read the entire Record. In its Brief (p. 3) the F.T.C. sets forth certain of the Commission's findings as to advertisements made by us. Then in a note (Note 4, p. 3, F.T.C. Brief), the writer observes:

"Said findings of the Commission . . . are not contested by petitioner before this Court. . . ."

Since the Record [II R. 5-9, incl.] contains a detailed stipulation as to the advertisements promulgated by us, it would certainly ill-behoove us, to say the least, to contest findings of the Commission which are based specifically upon our own stipulation.

We have never denied the advertising and so, to save time and get to the merits in the most expeditious way we knew how, we simply agreed and stipulated that we had done the advertising in the language alleged.

This verbal stipulation also was not novel; in our Answer [I R. 15-26, incl.], there are contained the same admissions in substance as in the stipulation.

The promulgation of the advertising was never an issue.

I.

Re Statement of the Case.

The F.T.C.'s statement of the case is a fairly correct summary of the proceedings had before the matter reached this Court.

II.

Re Questions Presented.

The subject of dissertation by F.T.C. under this heading is confusing:

Part of the F.T.C.'s decision (designated as two decisions by the F.T.C.) is said to be "interlocutory, the other final" (F.T.C. Brief, p. 7). Just how this distinction is made or appears is not explained—nor what bearing this has—since on the next page, the F.T.C. says:

"This Court, of course, under its review powers can examine the interlocutory decisions rendered by the Commission to determine whether the Commission's rulings on alleged errors committed by the examiner are of such a nature as to materially affect the validity of the findings as to the facts and the order to cease and desist entered by the Commission."

We cannot see but that the F.T.C. is trying by procedural legerdemain to tell this Court that this Court cannot look all the way down the administrative ladder, but must stop at the Commission level, and can in no wise review the activities of the Hearing Examiner below that level.

Yet, upon the very next page (F.T.C. Brief, p. 8), the F.T.C. would have this Court infer from its statement that "exceptions"—as required by F.T.C. Rule XXIII C (3)—were not made during the course of the administrative procedure, and the F.T.C. infers to this Court that some issues were not presented to the Commission. To clarify this, we insert, as an appendix to this Brief, certain exactly quoted excerpts from our Brief before the Federal Trade Commission in this matter. Particularly, we insert the following exceptions:

"4. EXCEPTIONS TO PREJUDICIAL ERRORS IN PROCEDURE, INCLUDING CONDUCT AND RULINGS OF THE HEARING EXAMINER.

"I. Exception is taken to the denial of the Hearing Examiner of Respondent's Motions to Strike from the Record. (Spec. 1 to 38, incl.)

"II. Exception is taken to the Hearing Examiner's rejection of Respondent's Offers of proof as follows:

- (a) Testimonials: Exhibits 20 to 20Z-72, inclusive (for Iden.).
- (b) 260 Doctors' Prescriptions, Exhibits 19 to 19Z 259, inclusive (for Iden.).
- (c) U. S. Letters Patent No. 2,287,341, issued June 23, 1942, by the United States Patent Office to Wm. C. Burns [Ex. 18 for Iden.].

- (d) Testimony of Dr. Frank Glassman (offered in Chicago). Offer of Proof offered November 28, 1951, under Motion of Respondent to Reopen.
- (e) The conduct of the Hearing Examiner, *i. e.*, a crusader instead of a judge."

And we offered sixteen pages of argument to the Hearing Examiner's rulings in our Brief before the Federal Trade Commission.

In addition, oral exceptions during the course of the taking of testimony were ruled by the Hearing Examiner to be noted as to adverse rulings without counsel's asking for them [I R. lines 17-22, incl.].

Hence, we submit, petitioner's rights as to all rulings of the administrative body below, both interlocutory and final, and including but not limited to the Hearing Examiner's evidentiary rulings are now properly before this Court as "interlocutory rulings."

On page 8, note 5, of its Brief, the naked, unsupported statement appears:

"Errors made by the examiner are not, as such, subject to review by a court of appeals."

Since, on the same page, the Commission states:

"This Court . . . can examine the interlocutory decisions rendered by the Commission to determine whether the Commission's rulings on alleged errors committed by the Examiner are of such a nature as to materially affect the validity of the findings as to the facts and the order to cease and desist entered by the Commission,"

we submit that we are here dealing with the, in law, well known distinction without a difference.

Since the F.T.C. points to no actual issues which it now says were not specifically raised, we submit that the Court should be presented with the argument as to the merits as soon as possible.

Our statement of points to be relied upon is not, we admit, as specific as is our specifications of error. We have not, in order to save space and the Court's time, developed categorically each of the ten points set forth as our "Question Involved" (pp. 6-7 of our Op. Br.). However, we have not thereby abandoned them, inasmuch as the substance is discussed without repeating each point as a title.

The F.T.C. would delete six out of our ten questions involved and, as to them, it would argue that we are not before the Court.

We submit, with all due respect to the F.T.C., that these procedural points are:

(a) Not well taken; and

(b) Typical of the F.T.C.'s supererogation of verbiage used by it continually throughout all of these proceedings to endeavor to make *words* take the place of facts, reality, and ideas.

The F.T.C. on page 10 of its Brief almost misstates the actualities with reference to the cases by it there cited.

In the case of *Refrigeration Engineering, Inc. v. York Corp.*, 168 F. 2d 896, 899, a patent case, this Court stated that the issue which it would not review on appeal

was not contained in the pleadings, findings, statement of points to be relied upon, or specifications of error.

In the case of *State Farm Mutual Auto Ins. Co. v. Porter*, 186 F. 2d 834, this Court stated, on the Petition for Rehearing:

“No specification of error is assigned and the statement of points relied on does not mention any such point.”

Since the questions involved are by us raised in general in the statement of points to be relied upon [I R. 201-204], and more specifically in our specifications of error (Our Op. Br. pp. 8-11, incl.), it would appear that the F.T.C. is not within the facts of the Record.

On page 13 of its Brief, the Commission (to our considerable amazement) says that we point to no specific finding which is not supported by the evidence.

We do not know how to be more specific than we are upon page 10 of our Brief, in which we quote verbatim from the Findings as set forth at I R. 182, I R. 183, I R. 180, I R. 184, I R. 178, and so forth.

Our citations, we believe are not only direct quotations, but also specific as to volume and page of the Record.

III.

Argument.

If supported by *substantial* evidence, the F.T.C.'s findings *are* conclusive. We have never agued this rule of law; we do not now. The statute says so (F.T.C. Act, §5; 52 Stat. 112, 113; 15 U.S.C. §45 (c)). Our argument here is to the substance of the evidence.

Dr. Engh had not even enough knowledge respecting our device to know which side goes up in the wearer's shoe [II R. 40]. On cross-examination he reluctantly admitted that under certain circumstances the device might be of some relief to the wearer [II R. 40].

As *demonstrated* in our Opening Brief, this same phenomenon occurred time after time when the experts for the Commission were examined. Each expert sought to qualify and limit the occasions and circumstances under which relief would come, but each admitted relief would come, and each admitted the truth of our advertising claims.

The Commission's attorney, however, throughout the entire proceeding, warily refrained from asking what results might be achieved from over two hundred different sizes carried in stock which differentiated as to "thicknesses, widths, and lengths" [II R. 278—unrefuted testimony of James H. Sewell]. The Hearing Examiner refused to listen to Dr. Glassman as to whether a doctor is needed to fit the device to the foot, and the Commission gave, we submit, only lip service to a consideration of what Dr. Glassman might have said.

Dr. Lewin himself, according to his own testimony [IV R. 939-940] always sends the patient to a shoemaker to fit the peripheral pads or cross bars in the shoes.

We cannot agree with the Commission that "four well qualified medical experts testified (other than categorically) that the results claimed could not be obtained by use of the device." As we pointed out in our Opening Brief, the Commission is bound by the *cross-examination* testimony of its own experts as well as by the direct.

Dr. Lewin, the great authority—summoned by the Commission—and relied upon by the Commission—with respect to his use of peripheral wedges and bars under the ball of the foot (for callouses), stated [IV R. 932 *et seq.*]:

"Question: What is the purpose of putting pads and wedges in a patient's shoes?

Trial Examiner Haycraft: Let's find out if he does it before you ask him that question, if he has ever done it or prescribed it.

Mr. Maury: Very well.

By Mr. Maury: Q. Doctor, in the course of your practice of orthopedic surgery do you engage in the treatment of people's feet? A. Yes.

Q. And in the course of so doing do you utilize felt pads within their shoes? A. Yes.

Q. What is the purpose of that? A. Well, one purpose is to relieve them of discomfort.

Q. Surely. And sometimes you use pads made of other materials, do you not? A. No, I think we are limited entirely to felt.

Q. You are limited entirely to felt? A. I think ours is limited entirely to felt.

Q. I see. But other materials are used in the profession, are they not? A. Oh, yes.

Q. What are some of those other materials?

A. Rubber, chiefly.

Q. Rubber. Is aluminum ever used? A. Aluminum?

Q. Yes. A. Pads?

Q. Pads, wedges or shapes? A. I don't see how you could use an aluminum pad.

Q. You do not. How about monel metal?

A. That is not a pad; that is an arch support, but that is metal.

Q. You use metal in arch supports? A. I very rarely use it; in the old days I did.

Q. In your book which we have discussed, 'The Foot and Ankle,' you describe a great many of these treatments, do you not, Doctor? A. Yes, but you will find somewhere where I recommend the use of resilient material, and the two chief resilient materials are felt and rubber.

Trial Examiner Haycraft: Do you mean absorbent rubber—foam rubber.

The Witness: Sponge rubber. That is too soft, but of different grades of resiliency.

By Mr. Maury: Q. How much resiliency does felt have? A. Felt has a lot of resiliency.

Q. That is, this power to return to its original shape after pressure is released? A. Shape and size after the compressive force is released.

Q. Doctor, calling your attention to Pages 101 and following of your book which, of course, you must see, do you therein describe a number of modifications of shoes which are used by you in the practice of your profession? A. What is the question? Here they are illustrated here. What is the question?

Q. I will frame several questions: Will you describe what a Thomas heel is? A. A Thomas heel

is one where the inner border is longer than the outer border, and the inner border is higher than the outer border.

Q. And how is that affixed to the shoes? A. Glued on and nailed in.

Q. It is glued on, but where is it applied? A. To the heel.

Q. Inside the shoe or outside? A. Outside the shoe.

Q. What effect does that have? A. It tips the weight to the outer border of the foot?

Q. By elevating the inner border? A. That is right. This (indicating).

Q. Now, what is a Dutchman? A. A Dutchman is a name, I don't know where it got the name of Dutchman, but is it synonymous with the word 'Cockie,' which some use. It is usually a piece of material that is beveled, so that it is higher in one area than in another, and so far as I know it is a term used by shoe men, cobblers, and I guess they taught it to the shoe fitters, so that it is in common parlance now, that you can go into any cobbler and get a Dutchman put in the inner border of your shoe or the outer border of your shoe to shift your balance.

Q. What does it do? How does it shift that balance, Doctor? A. Well, if you put one under the outer border of your foot it will shift to the medial border; if you put one under the inner border of the heel or sole it will shift to the outer border.

Q. It elevates one side? A. It elevates one side, and then it is skived off so it gradually grades down to zero.

Q. When you elevate one side it shifts weight to the other doesn't it? That is elemental? A. To

some other side, because it can be beveled anteriorly and posteriorly towards the toes or towards the heel.

Q. What is a metatarsal bar, Doctor? A. A metatarsal bar is an object that is placed on the sole of the shoe, or between the layers of the sole of the shoe, just back of the metatarsal heads.

Q. Yes, sir. A. It is usually made of leather; it may be made of rubber or a composition. Q. What is the Lewin rubber metatarsal crescent, Doctor? A. Well, in World War II, at Camp Taylor, Kentucky, the thought occurred to me that in the Jones bar we were using a straight object to support a curved structure—

Q. Yes. A. (Continuing)—and therefor the idea struck me that that should be a curved object, that one should use a curved object to correct a curved structure or to support a curved structure.

Q. Yes. Doctor, you have illustrated these various types of devices on Page 103 of your book, have you not? A. Yes. There is the Jones bar, and there is the Lewin metatarsal crescent.

Trial Examiner Haycraft: Are you going to have a photostatic copy made of that?

Mr. Maury: I will ask leave of the Examiner to have Page 103 of the Doctor's book photostated and offer it in evidence.

Trial Examiner Haycraft: Mr. Reporter, that will be marked Respondent's Exhibit 29 for identification."

(The page referred to was marked Respondent's Exhibit 129 for identification.)

"Trial Examiner Haycraft: Is there any objection?

Mr. Bellinger: No objection.

Trial Examiner Haycraft: It may be received."

(The page referred to, heretofore marked for identification Respondent's Exhibit 29, was received in evidence.)

"By Mr. Mary: Q. Calling your attention to this page, the diagrams demonstrate types of bars and pads? A. No, modification of shoes.

Q. Modification of shoes? A. Yes.

Q. What is the general purpose of these modifications of shoes? A. To relieve people of weight bearing on certain areas, to give them some degree of comfort, and to balance their feet more properly.

Q. You have found throughout your experience that these devices are effective in that respect? A. Yes, sir.

Q. Calling your attention to Commission's Exhibit 3 in evidence, and to the forward section thereof, can you tell us whether there is any similarity between that and the Lewin rubber metatarsal crescent illustrated in your book on Page 103? A. Whether there is any similarity?

Q. Yes, sir. A. Between what?

Q. Between the Lewin rubber metatarsal crescent and the device now before you? A. This goes on the bottom of a shoe?

Q. It goes on the bottom of a shoe? A. Yes.

Q. But it does have the effect of raising that area slightly, does it not? A. That is right.

Q. And what would be the effect of— A. Wait a minute. You said it has the effect of raising it?

Q. Raising that area of the foot? A. Oh, it isn't for that purpose.

Q. What is the purpose of that? A. The purpose is to transmit the weight from the heel to an area back of the metatarsal heads and relieve those heads of pressure.

Q. I see. And it does that by elevating the area back of the metatarsals, does it not? A. I don't know that it elevates it. It is a weight-bearing point, so that the person transmits his weight from the heel to an area just back of the metatarsal heads, instead of having the weight come down on the metatarsal heads.

Q. I see. A. It is sometimes called an anterior heel, that the ordinary heel that the shoe comes with is the posterior heel, and this is an anterior heel over which the foot rocks, but so far as pushing up on anything, I don't know that that occurs. I tried to do it, but when it is attached to the shoe it is just another weight-bearing point.

Q. But it does transfer weight? A. From the heel to the forefoot.

Q. Does it transfer any weight from the metatarsal heads to the points back of them? A. No, it is to relieve pressure or weight on the metatarsal heads.

Q. Then it takes weight off the metatarsal heads? A. That is right.

Q. What effect would that have on callouses of the metatarsal arch area? A. It might help, it should help them.

Q. Have you used them for that purpose, Doctor? A. Yes.

Q. That is a very frequent prescription, is it not? A. Yes.

Q. You do prescribe these things for various persons? A. Individually.

Q. Individually? A. Always.

Q. But you send them to the shoemaker to have them executed, do you not? A. That is right.

Q. Is the same true of the other devices which you depict on that page, Doctor, that you prescribe them for various patients? A. I prescribe some of them. That was an illustration of the principal ones.

Q. Yes. A. I don't know that any one person uses all of those.

Q. Surely. But they may be used in combination, too, may they not? A. Yes.

Q. Depending on the person's foot? A. That is right.

Q. And the object is to give the person relief from foot pains? A. That is one of the purposes, to give them relief from discomfort.

Q. And to aid them in balance, is it not, Doctor? A. Yes.

Q. And to perhaps improve his stance? A. Yes.

Q. Also to take weight-bearing off of sensitive parts of the feet? A. Yes.

Q. And to transfer it to other parts of the feet? A. Yes, sir.

Mr. Maury: I would like also to offer in evidence some of the material in the book. Perhaps I could do it by the question and answer method, if you prefer.

Trial Examiner Haycraft: I would rather you would.

Mr. Maury: Very well. I will try to do that. It is going to be chiefly reading from the book and asking the witness if he stands by that statement, and I might just ask him this general question?

By Mr. Maury: Q. Doctor, with reference to your dissertation upon modifications of shoes in your

book, in your 1947 Edition, do you consider that truthful and adequate as of the present day? A. I think so.

Q. Thank you. Then may I read it into the record?

Trial Examiner Haycraft: Yes.

Mr. Maury: I will read into evidence the dissertation and also offer the other diagrams shown by a photostatic copy.

Trial Examiner Haycraft: Do you have any more than you have already called attention to?

Mr. Maury: Yes, Figure 41 on Page 104.

Trial Examiner Haycraft: Mr. Reporter, that will be marked Respondent's Exhibit 30."

Dr. Lewin's methods, it would seem, on cross-examination, parallel our own. Dr. Lewin modifies shoes [IV R. 937]. We sell modifying inserts. He might easily have been the ad writer as well as the inventor!

If a million buyers have derived comfort by the use of Dr. Lewin's devices, as used in our 200 combinations, and if no member of the public has a complaint, can it not be rationally said that the naked, conclusory, categorical opinions of the experts, as distinguished from their specific experience and practice, as shown by their cross-examination, constitute insubstantial evidence?

The Commission has tacitly acceded to our statement of the "substantial evidence" rule (F.T.C. Brief, p. 11). The Commission's experts, we most sincerely feel, proved positively our contentions. And this evidence in our favor, *adduced by the Commission itself*, and by which the Commission was bound under the law, was utterly disregarded.

The "absolute rebuttal" by Dr. Philip Lewin of Doctors Hiss and Garner as to the effects of a Thomas bar [IV R. 846-848] relied upon by the F.T.C. shows clearly that there may be some confusion in the profession as to what is meant by a Thomas bar; but when we become more specific in definition and use, the bar across the ball of the foot just behind the metatarsal heads without designation as to whether it is Thomas' or Jones', we find Dr. Lewin, on page 847, calling it a Jones bar and stating that it "is a strip of metal on the bottom of the shoe sometimes attached to or incorporated in the sole of the shoe. It is a straight object that goes behind the first and fifth metatarsal bones. That is, the heads of them, and that is the Jones bar."

Dr. Lewin distinguishes the Thomas heel as a different device altogether. At IV R. 934, he again states that a Thomas heel "is one where the inner border is longer than the outer border and the inner border is higher than the outer border."

Further [IV R. 935], Dr. Lewin states that "a metatarsal bar is an object that is placed on the sole of a shoe or between the layers of the sole of a shoe just back of the metatarsal heads."

Dr. Lewin defines his own invention, the Lewin Rubber Metatarsal Crescent, as a curved type of support evolved by him to support a curved structure. It is illustrated as Respondent's Exhibit 29 in Evidence.

Consequently, while Dr. Lewin did undoubtedly clear the Record as to the meaning of a Thomas bar, he also proved that a metatarsal bar or crescent is his own prescription and invention for callouses, just as we use it.

IV.

Balance.

We agree with the F.T.C. that "words mean what people understand them to mean" (*Benton Announcements v. Federal Trade Commission*, 130 F. 2d 254, 255); and also that it does not matter much what we understand the word "balance" to mean. It is what the ordinary use of the word means, and not the complicated meaning given it by the F.T.C. and the experts. When we want to know what a word means, we look it up, and we find that Webster's dictionary (Webster's New International Dictionary, 2nd Ed. Unabridged 1950, Copyright G. & C. Merriam Co.) is an excellent authority. "Balance," according to Webster, has a rather extended series of meanings, both as a noun and a verb. We do not feel that either the accounting meaning of the word or the hyper-technical anatomical meaning is involved in our advertising. We do feel that where we say "balance" in our advertising, or body balance, we imply to the general public that we make it easier for the wearer to stand on his feet. At least, that is what we are trying to imply, and we are not (as we believe the F.T.C. is) like Humpty Dumpty in "Alice Through the Looking Glass," trying to make words mean what we choose them to mean, "neither more or less," nor are we trying to be the master of the word.¹

¹" 'Certainly,' said Alice.

" 'And only *one* for birthday presents, you know. There's glory for you!' (said Humpty Dumpty).

" 'I don't know what you mean by "glory." ' ' ' Alice said.

" Humpty Dumpty smiled contemptuously. 'Of course you don't—till I tell you. I meant "there's a nice knock-down argument for you!" ' "

It is still true that a pyramid balances better on its base than on its point. So long as the under-foot is rounded in contour, wedges at the side will aid balance—and all the verbiage of the Commission's experts cannot alter the facts of nature.

V. Fair Trial.

The F.T.C. has in no wise answered our contentions here. It mistakes constitutionality for fairness. Nowhere have we raised the issue of the constitutionality of the F.T.C. Act, the F.T.C., or these proceedings.

We do, however, contend that the whole process—as it *has occurred in this case*—has resulted in an unfair hearing for our client. And it should be here noted parenthetically that the “dual function” of the F.C.T., mentioned by the courts (*National Harness Mfrs. Assn. v. Federal Trade Commission*, 268 Fed. 705, 707; *Federal Trade Commission v. Klesner*, 280 U. S. 19, 27), has in this case become a *triple* function. F.T.C. here, in addition to being both prosecutor and judge, is also the complaining witness (and insofar as F.T.C. makes its own rules, it is a legislature too). The unfairness is our point; constitutionality was by the courts settled long ago. Un-

“‘But “glory” doesn't mean “a nice knock-down argument,”’ Alice objected.

“‘When *I* use the word,’ Humpty Dumpty said, in rather a scornful tone, ‘It means just what I choose it to mean—neither more nor less.’

“‘The question is,’ said Alice, ‘whether you *can* make words mean so many different things.’

“‘The question is,’ said Humpty Dumpty, ‘which is to be master—that's all.’” (Alice Through the Looking Glass, by Lewis Carroll.)

fairness can occur in any tribunal, regardless of the constitutionality of the forum. We submit it has here.

As was said by this Court in the case of *Carter v. Federal Trade Commission*, 201 F. 2d 446:

“We are of the opinion, however, that the cumulative effect of these unjustifiable restrictions on the cross-examination of key witnesses for the Commission was to deprive the petitioner of a fair hearing. Such being the case, the court is not disposed to speculate as to what would have been the outcome had a fair and impartial hearing been accorded.”

Citing:

Inland Steel v. N.L.R.B., 7 Cir., 109 F. 2d 9;

Empire Oil & Gas Co. v. U. S., 9 Cir., 136 F. 2d 868, 871;

Willapoint Oysters v. Ewing, 9 Cir., 174 F. 2d 676, cert. den. 338 U. S. 860, 70 S. Ct. 101, 94 L. Ed. 577;

Cf. Reilly v. Pincus, 338 U. S. 269, 70 S. Ct. 110, 94 L. Ed. 63.

Conclusion.

It is respectfully submitted that the decision and order of the Federal Trade Commission should be set aside.

MAURY, LARSEN & HUNT,

By GEORGE R. MAURY,

Attorneys for Petitioner.

APPENDIX.

Quotation From Respondent's Brief on Appeal to the Commission (de hors the Record).

B. Exceptions.

1. EXCEPTIONS TO SPECIFIC FINDINGS.

The Respondent makes the following exceptions to specific Findings of the Hearing Examiner as follows:

I.

As to the rulings on proposed Findings and Conclusions submitted by the attorney in support of the Complaint, the Respondent excepts to the rulings of the Hearing Examiner in allowing the Findings proposed in paragraph numbered Four of Mr. Bellinger's proposed Findings for that said Finding is vague, in that it cannot be determined what "allowed in substance" means, and in that it is contrary to the preponderance of the evidence, and in that it is based upon evidence which is incredible and based upon the Hearing Examiner's refusal to hear evidence which was offered.

II.

The Respondent excepts to the Hearing Examiner's allowing paragraph Nine of the Findings, etc. proposed by Mr. Bellinger on the following grounds: That said Finding is vague in that it cannot be determined therefrom what "allowed in substance" means when applied to paragraph Five; on the further ground that the Finding is contrary to the preponderance of the evidence and is not supported by any credible evidence whatsoever.

III.

The Respondent excepts to the Conclusion proposed by Mr. Bellinger and "allowed in substance" on the fol-

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III.

The Respondent excepts to the Conclusion proposed by Mr. Bellinger and "allowed in substance" on the fol-

lowing grounds: That the Conclusion is vague in that it cannot be determined what "allowed in substance" means, and in that the Conclusion itself is not a proper Conclusion to be drawn from the evidence or from proper Findings; and on the further ground that the advertisements of the Respondent do not deceive the public and they do not constitute unfair and deceptive acts or practices in commerce or otherwise within the intent and meaning of the Federal Trade Commission Act.

IV.

Each and all of said Findings are based upon evidence which was inadmissible and should have been stricken from the record under a proper application of the Hearing Examiner's own rulings with reference to Respondent's evidence.

2. EXCEPTIONS TO RULINGS ON RESPONDENT'S FINDINGS.

Exceptions in this category follow the numerical designations of Respondent's Proposed Findings of Fact and Conclusions of Law, and the same designations made by the Hearing Examiner in his ruling on Respondent's proposed Findings.

V.

While Finding V proposed by Respondent is negative, nevertheless an examination of the complete record reveals that there is absolutely no evidence whatsoever concerning other or different advertisements than those set forth and, therefore, exception is taken to the denial of the Hearing Examiner of this proposed negative finding.

VI.

As to Finding Numbered VI(1), (7), (8), (9), (12), (13), (14), (16), (17), (18), (19), (22), (23), (24), (25), and (26), the Respondent makes the following specific exceptions as to each of the foregoing Findings subnumbered under VI: Each of said proposed Findings of the Respondent is supported by substantial, reliable and probative evidence, and the Federal Trade Commission by Mr. Bellinger failed to sustain the burden of proof to the contrary throughout the entire hearings; and on the further ground that the truth of the matter is pragmatically established; on the further ground that the Hearing Examiner refused to admit evidence probative of the truth of each of said statements after offers of proof were duly made.

As to the following special Findings under the major numeral VI, the Respondent makes the following specific exceptions:

VI(2) is excepted to upon the ground that the only evidence in the record is that this statement was discontinued by the Respondent at the request of the Federal Trade Commission. [Tr. p. 656.]

VIII.

As to VIII, the Respondent specifically excepts to the denied portion thereof; that is to say, he excepts to the denial by the Hearing Examiner as to the truth of the proposed Finding not being supported by substantial, reliable and probative evidence; he also excepts to the vagueness of the ruling on the ground that no discrimination is made between body balance and foot balance; on the further ground that the proposed Finding is not supported by the evidence and the preponderance of the evi-

dence is to the contrary, namely, that representations that the device will assist the wearer to attain better body balance are true and that the representations that the device will assist the wearer to attain better foot balance are likewise true.

XII.

Exception is taken to the vagueness of the statement of the Hearing Examiner in that it cannot be determined what is meant by "and denied as to the limited extent of the representation" in that no limit is set forth by the Hearing Examiner by which a standard may be set up; and on the further ground that the truth of the representations has been established by the preponderance of the evidence; and on the further ground that the same is contrary to the Finding of the Hearing Examiner under number X in his Findings.

XIII and XIV.

Respondent specifically excepts to these on the ground that the preponderance of the evidence is to the contrary of the ruling of the Hearing Examiner, and the truth of the advertising is supported by substantial, reliable and probative evidence.

XVI.

Respondent excepts to the Hearing Examiner's ruling under XVI on the ground that it is contrary to the weight of the evidence, that the representation is true, and that it is supported by substantial, reliable and probative evidence.

XVII.

Respondent excepts to this Finding on the ground that it is contrary to all of the evidence and that no Finding

has been made on the cessation of the use of the representation.

XVIII.

Respondent excepts to the Finding of the Hearing Examiner on the ground that the truth of the representation is established by all the medical testimony that was produced, and on the ground that the preponderance of the evidence is to the contrary.

XIX.

Respondent excepts to this Finding on the ground that the preponderance of the evidence is to the contrary.

XX.

Respondent excepts to this Finding on the ground that the preponderance of the evidence is to the contrary, and the statement is supported by sound, substantial, reliable and probative evidence.

XXI.

Respondent excepts to this on the ground that all of the medical witnesses agreed as to the truth of this representation and that all of the evidence including the preponderance is to the contrary of the Hearing Examiner's Finding.

XXII.

Respondent excepts to this upon the ground that all of the evidence is to the contrary.

XXIV.

Respondent excepts to this on the ground that this is contrary to the preponderance of the evidence and contrary to the Hearing Examiner's Finding numbered X.

XXVI, XXVII, XXVIII, XXIX, XXX, XXXIII, XXXIV, XXXV, XXXVI, XXXIX, XL, XLI, XLII, XLV.

Respondent excepts to these on the ground that each and all of the foregoing rulings of the Hearing Examiner are contrary to the preponderance of the evidence and contrary to the experience of the only witnesses who testified and said Findings are based upon irrelevant and inadmissible testimony which should have been stricken.

XXXI and XXXII.

Respondent excepts to these on the ground that the whole point of the case is contained in this Finding in essence, and that the description by the Hearing Examiner of the same as “meaningless and irrelevant” indicates the lack of understanding of the Hearing Examiner of the uncontroverted evidence produced.

XLIII.

Respondent excepts to this ruling on the ground that the evidence upon which said proposed Finding is based goes to the essence of the transaction of purchase by the public.

XLIV.

Respondent excepts to this ruling of the Hearing Examiner on the ground that the preponderance of the evidence is to the contrary.

XLV.

Respondent excepts to this ruling of the Hearing Examiner on the ground that all of the medical testimony produced supports this proposed Finding.

As to Respondent's proposed Conclusions of Law, the Respondent excepts to the failure of the Hearing Ex-

aminer to make any ruling as to Respondent's proposed Conclusions of Law except by implication, and excepts to the implied refusal to sustain the Conclusions proposed by Respondent.

3. EXCEPTIONS TO INITIAL DECISION.

Respondent excepts to the Initial Decision of the Hearing Examiner as follows:

I. Respondent excepts to the finding of the Hearing Examiner as to the facts on the following grounds: (a) That the description of the device is not accurate in that it is too generally stated "where the elevations along its sides" are located in defining them only "where the sides of the wearer's heel are raised by such elevations." This indicates the Hearing Examiner's lack of definite knowledge, understanding, and complete study as to the structure of the device.

II. Respondent excepts to the specific Finding in paragraph Four (f) and (g) on the ground that nearly six years have elapsed since the respondent ceased using these representations in order to cooperate with the Federal Trade Commission, and that to insert them in any decision whatever now, or to make any issue whatsoever of them, is nothing but administrative persecution.

III. As to paragraph Five, Respondent's exception is taken to the derogatory remarks of the Hearing Examiner as follows: "And another doctor, an osteopath" in that the Hearing Examiner fails to state that this osteopath is also a medical doctor, and the most experienced foot specialist produced by either side.

IV. Specific exception, of course, is taken to paragraph Five where it is found that the statements involved

constitute false advertisements. This is a conclusion, not a finding, and is not supported by the evidence, nor is it in accord with the preponderance of the evidence.

V. Exception is taken to paragraph Six upon the ground that it describes only body balance upon the foot, called stance, and does not deal with any foot function dynamically, and any finding that the Respondent's device does not assist in balancing the foot and in that it injects into the advertising a meaning to the word "balance" which is not there in ordinary lay understanding and then proceeds to find that such interpolated meaning is not true. Exception is also taken to the Finding therein that the cuboid bone is not the focal point of weight bearing, either in stance or locomotion as being contrary to all the medical testimony.

VI. Respondent excepts to paragraph Seven upon the ground that said paragraph is entirely a conclusion of the Hearing Examiner and not a finding of fact; also on the ground that paragraph Seven is contrary to the allowed finding proposed by the Respondent; and contrary to the testimony of all of the physicians and interpolates into itself or its reason for being many of the representations which have been voluntarily discontinued by the Respondent in order to cooperate with the Federal Trade Commission and with respect to the effect of the device upon calloused feet conditions, it is directly contrary to all of the evidence.

VII. Exception is taken to the so-called Conclusion upon the ground that it is entirely in the words of the statute and in nowise descends to particulars, and does not explain its meaning as applied to this device.

4. EXCEPTIONS TO PREJUDICIAL ERRORS IN PROCEDURE,
INCLUDING CONDUCT AND RULINGS OF THE HEARING
EXAMINER.

I. Exception is taken to the denial of the Hearing Examiner of Respondent's Motions to Strike from the Record. [Spec. 1 to 38, incl.]

II. Exception is taken to the Hearing Examiner's rejection of Respondent's Offers of proof as follows:

- (a) Testimonials: Exhibits 20 to 20Z-72, inclusive (for Iden.).
- (b) 260 Doctors' Prescriptions, Exhibits 19 to 19-Z-259, inclusive (for Iden.).
- (c) U. S. Letters Patent No. 2,287-341, issued June 23, 1942, by the United States Patent Office to Wm. C. Burns [Ex. 18 for Iden.].
- (d) Testimony of Dr. Frank Glassman (offered in Chicago). Offer of Proof offered November 28, 1951, under Motion of Respondent to Reopen.
- (e) The conduct of the Hearing Examiner, *i. e.*, a crusader instead of a judge.

5. EXCEPTIONS TO FAILURE OF THE INITIAL DECISION
TO INCLUDE OTHER FINDINGS AND CONCLUSIONS.

I. Exception is taken to the failure of the Initial Decision to describe more accurately the device.

II. Exception is taken to the failure of the Initial Decision to explain understandably the function of the device.

III. Exception is taken to the failure of the Initial Decision to find the truth of the affirmative allegations in Respondents' Answer and foot diagram thereto attached,

showing the focal point of weight pressure passing under the cuboid bone when the foot is in action. (This was established by *all* the doctors.)

IV. Exception is taken to the failure of the Initial Decision to find that the medical profession generally accepts the device, prescribes it, and holds that no necessity exists for any orthopedic prescription, in the usual case of foot pain.

